Supreme Court U.S.
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No. 02-709

IN THE

Supreme Court of the United States

BETTINA J. SCHUETZ,
and all others similarly situated,
Petitioner,

v.

BANC ONE MORTGAGE CORPORATION,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether the court of appeals, consistent with the holdings of this Court and with the decisions of the only two other circuits to have considered the question, properly accorded deference to a two-part liability test set forth in binding policy statements issued by the Department of Housing and Urban Development pursuant to an explicit congressional delegation of authority under the Real Estate Settlement Procedures Act, 12 U.S.C. § 2607.

2. Whether the court of appeals, in applying HUD's two-part liability test, properly affirmed the discretionary denial of class certification because loan-specific questions predominate, and properly affirmed the grant of summary judgment in favor of Respondent based upon the undisputed material facts.

PARTIES TO THE PROCEEDING

The Petitioner is Bettina J. Schuetz, individually and as a representative of a putative class of similarly situated persons. The Respondent is Banc One Mortgage Corporation. The petition properly identifies additional parties who participated in the proceedings in the district court but did not participate in the proceedings in the court of appeals.

CORPORATE DISCLOSURE

Respondent Banc One Mortgage Corporation was a wholly-owned subsidiary of Bank One, N.A. (Ohio). On September 1, 2001, Banc One Mortgage Corporation merged with and into Bank One, N.A. (Ohio). Bank One, N.A. (Ohio), the successor by merger to Banc One Mortgage Corporation, is a wholly-owned subsidiary of Bank One Corporation, a corporation which has issued securities to the public.

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STATUTORY AND REGULATORY PROVISIONS INVOLVED

The full text of the following provisions appears in the Petitioner's Appendix ("Pet. App.") at 76a-120a:

12 U.S.C. § 2607(a), (c).
12 U.S.C. § 2617(a), (b).
24 C.F.R. § 3500.4(a)(1)(ii).
24 C.F.R. § 3500.14(g)(1), (2).

The full text of the following provisions appears in the Respondent's Appendix ("RA") at 1a-64a:

Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers; Final Rule, 64 FED. REG. 10,080 (Mar. 1, 1999).

Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b); Final Rule, 66 FED. REG. 53,052 (Oct. 18, 2001).

INTRODUCTION

Petitioner Bettina Schuetz ("Schuetz") seeks review of a Ninth Circuit decision which affirmed the denial of class certification and the grant of summary judgment in favor of Respondent Banc One Mortgage Corporation ("Banc One") in an action challenging lender payments to mortgage brokers under Section 8 of the Real Estate Settlement Procedures Act ("RESPA"). The Ninth Circuit (like the only other two circuits courts to have addressed the same issue) properly deferred to a two-part liability test set forth in two binding policy statements issued by the Department of Housing and Urban Development ("HUD"). In applying HUD's two-part test, the Ninth Circuit properly concluded that individual, not

common, questions predominate and that the district court did not abuse its discretion in denying class certification. The court of appeals also properly affirmed the grant of summary judgment to Banc One, as there were no disputed material facts and Banc One was entitled to judgment as a matter of law under HUD's two-part liability test.

The Petition should be denied for a variety of reasons. First, there is no conflict among the circuits warranting this Court's review. The Ninth Circuit and the only two other circuit courts (the Eighth and Eleventh) to have addressed the issue have uniformly concluded that HUD's statements of policy, issued pursuant to clear statutory authority and in response to congressional directives, are entitled to deference. Indeed, every district court to have considered this question since HUD issued its 2001 Policy Statement has accorded deference to HUD's test. Likewise, the courts of appeals have uniformly concluded that challenges to lender-paid compensation to mortgage brokers under RESPA Section 8 may not proceed as class actions. In addition to the three circuit court decisions, approximately 50 district courts have also denied class certification in analogous cases.

Second, this Court earlier this Term denied certiorari in a petition raising the same question presented by the Petition here. *See Glover v. Standard Fed. Bank*, 283 F.3d 953 (8th Cir), *cert. denied*, No. 01-1648, __ U.S. __, 123 S. Ct. 344 (Oct. 7, 2002). Nothing has occurred in the interim to warrant a different disposition here.

Third, the Ninth Circuit's decision is in full accord with this Court's prior precedent on deference to administrative agencies. The Petition relies primarily on this Court's decision in *Adams Fruit*, which is inapposite because HUD acted pursuant to its congressionally delegated authority to implement RESPA, and because HUD's policy statements did not encroach upon Section 8's private right of action. Moreover, alternative legal grounds, which were presented but not

addressed below, fully support the decision of the court of appeals. At best, Schuetz asks this Court to perform an error-correcting function regarding the class certification and summary judgment rulings of the district court and the court of appeals, an inappropriate reason to grant review. In sum, this Court should deny the Petition.

STATEMENT OF THE CASE

A. The Wholesale Mortgage Industry and Yield Spread Premiums.

Historically, home buyers obtained mortgage loans directly from local banks or savings and loans that used their own retail offices and funds. *See* Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers; Final Rule, 64 FED. REG. 10,080, 10,080 (Mar. 1, 1999) ("1999 Policy Statement") (RA 4a). Starting in the 1980s, independent mortgage brokers began offering mortgage loans at a retail level that were funded and acquired by wholesale lenders at closing. *Id.* Today, mortgage brokers originate approximately half of all mortgage loans made in the United States. *Id.* In addition to furnishing "facilities" and "goods," such as office space, equipment, staff and the documentation that comprises a mortgage loan, mortgage brokers perform myriad "services" necessary to create a loan package for a lender to fund and acquire.[1] *Id.* at 10,081, 10,085 (RA 21a-24a). The amount

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[1] These services include, among other things, taking information from borrowers and completing applications; analyzing prospective borrowers' income and debt and prequalifying borrowers to determine the maximum loan amount they can afford; counseling borrowers about loan products, the lending process, and credit-qualification underwriting issues; collecting and verifying financial information; providing disclosures; obtaining credit reports; ordering legal documents; initiating property inspections and appraisals; preparing loan documents; and participating in closings. *See* 64 FED. REG. at 10,085 (RA 21a-22a).

and difficulty of a broker's work necessarily varies for each particular loan. *Id.* at 10,081 (RA 5a). Like many lenders, Banc One offers mortgage loans both on a retail basis and on a wholesale basis through a national network of approximately 700 nonexclusive mortgage brokers. (Exc. 216-17; Supp. Exc. 166.[2])

A mortgage broker's compensation for originating a loan may be paid directly by the borrower in up-front fees, indirectly by financing the fees through a slightly higher interest rate in exchange for lender payments to the broker, or by some combination of both. *Id.* at 10,081 (RA 5a). HUD has therefore concluded that lender payments to mortgage brokers "foster[] homeownership" by enabling borrowers to obtain loans without paying fees directly. Real Estate Settlement Procedures Act Statement of Policy 2001-1: Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b); Final Rule, 66 FED. REG. 53,052, 53,054 (Oct. 18, 2001) ("2001 Policy Statement") (RA 41a). Among the most common types of lender payments are "yield spread premiums," which are calculated, in part, based on the interest rate of the loan. Daily, lenders send brokers rate sheets listing a range of wholesale loan prices, expressed in relationship to a bench-mark "par" interest rate.[3] 1999 Policy Statement, 64 FED. REG. at 10,081 (RA 6a). For loans below the par rate, lenders charge discount points, while for loans above the par rate, lenders pay yield spread premiums. *Id.* Thus, depending upon a

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[2] Citations to the record in the court of appeals are to Appellant Bettina Schuetz's Excerpts of Record ("Exc."), and Appellee Banc One's Supplemental Excerpts of Record ("Supp. Exc.").

[3] Contrary to Petitioner's suggestion (Pet. 5), "par" is not synonymous with market rate or the interest rate at which Banc One will make a loan at retail. A borrower is *not* entitled to a par loan unless the borrower pays *all* the broker's compensation directly. (Exc. 220-23.)

borrower's objectives, financial position, and cash on hand, brokers are able to offer a spectrum of interest rate and up-front cost combinations.[4]

B. The Statutory and Regulatory Framework.

In 1974, before the existence of the mortgage brokerage industry, Congress enacted the Real Estate Settlement Procedures Act ("RESPA") to protect home buyers from "unnecessarily high settlement charges caused by certain abusive practices." 12 U.S.C. § 2601(a) (Pet. App. 76a). In Section 8(a), RESPA prohibits giving or receiving "any fee, kickback, or thing of value pursuant to any agreement or understanding ... that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person." *Id.* § 2607(a) (Pet. App. 90a). This general prohibition against referral fees and kickbacks is modified, however, by Section 8(c) of the Act, which provides that "[n]othing in this section [8] shall be construed as prohibiting ... payment for goods or facilities actually furnished or for services actually performed." *Id.* § 2607(c)(2) (Pet. App. 91a).

In Section 19(a) of RESPA, Congress expressly delegated to HUD authority to "prescribe such rules and regulations, to make such interpretations, and to grant such reasonable exemptions for classes of transactions, as may be necessary to achieve the purposes of this [Act]." *See* 12 U.S.C. § 2617(a) (Pet. App. 94a). HUD has promulgated certain regulations implementing RESPA, *see* 24 C.F.R. § 3500 *et seq.*, commonly referred to as "Regulation X," *id.* § 3500.1. Regulation X specifies that while "Section 8 of RESPA permits . . . payment for goods or facilities actually furnished or for services actually performed," *id.* § 3500.14(g)(1)(iv) (Pet.

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[4] In the case of *no-cost* loans, for example, all the broker's compensation is paid by the lender through a yield spread premium. (Exc. 223; Supp. Exc. 10-11.)

App. 112a), "[i]f the payment ... bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided," *id.* § 3500.14(g)(2) (Pet. App. 113a).

In Section 19(b), Congress provided a safe harbor from the prohibitions of Section 8 for "any act done or omitted in good faith in conformity with any rule, regulation, or interpretation" by HUD. 12 U.S.C. § 2617(b) (Pet. App. 94a). HUD has provided that such "a rule, regulation or interpretation" includes any "document that is published in the FEDERAL REGISTER by the Secretary and states that it is an 'interpretation,' 'interpretative rule,' 'commentary,' or a 'statement of policy' for purposes of [§ 2617(a)]." 24 C.F.R. § 3500.4(a)(1)(ii) (Pet. App. 106a).

Acting under its congressionally delegated authority in Section 19(a), and in response to a 1998 House Conference Report directive,[5] HUD issued the 1999 Policy Statement setting forth a two-part test for determining the legality of lender payments to mortgage brokers, including yield spread premiums, under Section 8 and Regulation X. *See* 64 FED. REG. at 10,080, 10,084 (RA 1a, 18a-20a). Under the HUD test, the threshold question is "whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker." *Id.* at 10,085 (RA 20a). To facilitate this initial determination,

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[5] In reaction to lawsuits challenging yield spread premiums under RESPA, the House Conference Report on the Veterans Affairs and HUD Appropriations Act, 1999 ("1998 House Conference Report") directed HUD to issue a "policy statement" within 90 days "to clarify its position" on the legality of lender payments to brokers under RESPA and to provide "guidance" to "the courts" and reduce the "legal uncertainty" surrounding the practice. *Id.* The 1998 House Conference Report emphasized that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations" of Section 8 of RESPA. *See* H.R. Conf. Rep. No. 105-769, at 260 (1998).

HUD identifies a typical set of compensable services and sets out minimum requirements for the number and types of such services that must be performed in order to satisfy step one. *Id.* (RA 21a-22a). The second—and determinative—question under the HUD test is whether the total compensation paid to the broker "is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed." *Id.* at 10,085-86 (RA 24a-28a). Under this latter step, "total compensation" encompasses both direct fees (from the borrower) and indirect fees (from the lender), including payments that are based on the "interest rate" of a loan, like yield spread premiums. *Id.* at 10,084, 10,086 (RA 26a). This "total compensation" must be "commensurate with that amount normally charged for similar services" which "requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets." *Id.* at 10,086 (RA 25a).

Most courts found that the HUD two-part test was clear, and that application of the test necessitated inquiry into the specific facts of each loan transaction, resulting in denials of class certification in dozens of RESPA yield spread premium cases around the country.[6] The only significant departure from this consistency was *Culpepper v. Irwin Mortgage Corp*, 253 F.3d 1324 (11th Cir. 2001), *cert. denied*, 534 U.S. 1118 (2002), where the Eleventh Circuit initially upheld class certification, holding that HUD's 1999 Policy Statement carried "the force of law," *id.* at 1329, but that it was "ambiguous." *Id.* at 1327. At that time, the Eleventh Circuit held, under its interpretation of HUD's test, that lender payments to brokers could be inferred to violate RESPA to the extent that the payments, analyzed in isolation, were calculated by the lender based on the interest rate on the rate sheet, rather than negotiated loan-by-loan. *See id.* at 1326, 1329-32.

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[6] *See infra* note 15.

Acting again pursuant to its authority under Section 19(a), and in response to conflicting judicial interpretations as a result of the Eleventh Circuit's decision in *Culpepper*, HUD issued the 2001 Policy Statement to "clarify" and "eliminate any ambiguity" in the 1999 Policy Statement. *See* 66 FED. REG. at 53,052, 53,053 (RA 33a, 37a). The 2001 Policy Statement "disagrees" with *Culpepper*, *id.* at 53,054-55 (RA 44a-45a), making clear that the "amount of the [yield spread premium] is not, under the HUD test, scrutinized separately and apart from total broker compensation." *Id.* at 53,053 (RA 37a). The 2001 Policy Statement emphasized that:

> [N]either Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion [of *Culpepper*] that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed.

Id. at 53,055 (RA 45a). Recognizing that *Culpepper* would eliminate lender payments that foster homeownership, HUD explained that the legality of a particular yield spread premium "cannot be determined by the use of a rate sheet," *id. 46a*, because yield spread premiums "are by definition derived from the interest rate," and "a rate sheet is merely a mechanism for displaying the yield spread premium, and does not indicate whether a particular yield spread premium is a payment for ... services...." *Id.* (RA 46a). Nothing in the 1999 Policy Statement, HUD explained, supported an analysis that "focus[es] exclusively on the presumed intent of the lender in making the payments." *Id.* at 53,054 (RA 44a). To the contrary, HUD relied upon "common industry practice" in which "lenders typically know that brokers have performed the services required." *Id.* at 53,055 (RA 45a).

HUD thus left no doubt that "[t]he legality of any yield spread premium can only be evaluated in the context of the test HUD established and the specific factual circumstances

applicable to each transaction in which a yield spread premium is used." *Id.* at 53,054 (RA 43a). As a result, the Eleventh Circuit "overrule[d]" *Culpepper* in *Heimmermann v. First Union Mortgage Corp.*, 305 F.3d 1257, 1264 (11th Cir. 2002), another case challenging yield spread premiums under Section 8 of RESPA. With *Heimmermann*, the Eleventh Circuit joins the only two other circuits to address the issue—the Ninth Circuit in this case and the Eighth Circuit in *Glover*, 283 F.3d 953—in affording deference to HUD's interpretation and rejecting class certification.

C. History of the Proceedings Below.

In August 1997, Schuetz, who was not an unsophisticated borrower,[7] wanted to finance the purchase of a home in the Sun Lakes Country Club in Arizona. Schuetz used a mortgage broker, Home Mortgage, to obtain a mortgage loan from Banc One in the amount of $68,800 at an interest rate of 7.5%.[8] (Supp. Exc. 168, 176.) Schuetz paid a $688 origination fee, a $688 discount fee, and a $285 processing fee to Home Mortgage, which received the rest of its compensation through a $516 yield spread premium from Banc One.[9] (Pet.

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[7] Schuetz formerly co-owned a residential construction company (Exc. 247) and had previously financed the purchase of two of her own homes. (*Id.* 247-48). She also had her realtor represent her in arranging for financing. (*Id.* 249-50.)

[8] Schuetz, who was familiar with prevailing interest rates (Exc. 258), originally applied for a loan with an 8% interest rate. (Supp. Exc. 48.) She chose not to lock in an interest rate at the time of application. (Supp. Exc. 54.) Instead, she checked with her regular bank (Exc. 270) to see if she could "save on anything." (*Id.*)

[9] Schuetz contends incorrectly that she "paid one 'discount point' to lower her interest rate." (Pet. 6.) Such discount points are paid to the *lender* funding the loan. Schuetz did *not* pay Banc One a discount point; rather, she paid her *broker* a "loan discount" fee (Pet. App. 125a), which was part of the broker's compensation for services rendered. (Exc. 123.) The name of the payment to the broker is irrelevant under HUD's test, which requires analysis of the broker's total compensation, whatever

App. 125a; Supp. Exc. 168.) The yield spread premium was disclosed to Schuetz on the good faith estimate she received at the time of application (Pet. App. 43a; Supp. Exc. 53, 190), and on the HUD-1 settlement statement she received at closing (Pet. App. 43a, 125a; Exc. 126), in precisely the manner mandated by HUD.[10] *See* 24 C.F.R. pt. 3500, App. B, Illus. 13; 64 FED. REG. at 10,087 (RA 29a); *see also* 24 C.F.R. pt. 3500, App. A, Section L (Instructions for Completing HUD-1). Although Schuetz refused to pay another type of settlement fee at closing (Exc. 124), she neither questioned nor objected to the yield spread premium.[11] (Exc. 255, 263.)

In February 1998, Schuetz commenced a class action lawsuit alleging that Banc One's payment of yield spread premiums violated Section 8 of RESPA. In March of the next year, and without benefit of HUD's 1999 Policy Statement, which was issued about the same time, the district court

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its form, not some portion of it in isolation. *See* 64 FED. REG. at 10,084 (RA 19a-20a).

[10] Schuetz asserts, incorrectly, that the yield spread premium should have been disclosed differently on her HUD-1 form. (Pet. 5-6.) HUD has made clear that Schuetz's suggested disclosure is not required. *See* 64 FED. REG. at 10,087 (RA 29a). Schuetz also ignores that she received (Exc. 127) HUD's settlement costs booklet explaining the settlement process, 41 FED. REG. 23,620 (June 10, 1976), 52 FED. REG. 13,566 (Apr. 23, 1987), and describing the sources of broker compensation and their relationship to points and interest rates. 62 FED. REG. 31,982 (June 11, 1997). Referring to statements of *another broker*, not involved with Schuetz's loan, Schuetz suggests, misleadingly, that *her broker* does not inform borrowers of the par rate (Pet. 5), ignoring Home Mortgage's testimony that it counseled Schuetz on the relationship between closing costs and interest rate. (Exc. 127; Supp. Exc. 71-74, 190-91.)

[11] Schuetz refused to pay a $172 escrow waiver fee charged by Banc One (Exc. 124), which Home Mortgage then paid for Schuetz (*id.*), thus reducing the amount of the yield spread premium from $516 to $344. (*Id.* 126.)

denied class certification on the grounds that whether the yield spread premium constituted reasonable payment for the broker's services could be resolved only on a loan-by-loan basis. (Pet. App. 56a.) In September 2000, deferring to the two-part test set forth in HUD's 1999 Policy Statement, the district court granted summary judgment in favor of Banc One, finding the record evidence undisputed that Home Mortgage had provided the requisite number and type of services identified by HUD and that Home Mortgage's total compensation was reasonable in relation to the market value of those services. (*Id.* 43a-47a.)

The Ninth Circuit affirmed both the denial of class certification and the grant of summary judgment to Banc One. In holding that HUD's interpretation in the 1999 and 2001 Policy Statements was entitled to *Chevron* deference, the Ninth Circuit recognized that Section 8 of RESPA does not specifically address the legality of yield spread premiums. (*Id.* 14a.) The Ninth Circuit also noted that "Congress authorized [HUD] to interpret RESPA, HUD has responsibility for enforcing the statute, and it has expertise in the home mortgage lending industry." (*Id.*) The Ninth Circuit concluded that HUD's interpretation is a reasonable construction of the statute, adopting the reasoning of the Eighth Circuit in *Glover*. (*Id.* 14a-15a.) HUD's two-part test, the Ninth Circuit explained, is consistent with RESPA's purpose because it "foster[s] home ownership" by enabling borrowers "with a dearth of cash at the time of settlement [to] front less money and pay for some of their mortgage broker's services over time," while at the same time "prohibiting payments that are for nothing else than the referral of business." (*Id.* 15a.)

The Ninth Circuit also held—citing *Barnhart v. Walton*, 535 U.S. 212, __, 122 S. Ct 1265, 1271 (2002) and *United States v. Mead Corp.*, 533 U.S. 218, 231 (2002)—that HUD's Policy Statements were subject to sufficiently formal process to warrant *Chevron* deference, despite the absence of notice-and-comment rulemaking. (Pet. App. 13a-14a.) In so

holding, the Ninth Circuit noted that HUD's 1999 Policy Statement, which was issued after consultation with interested industry, consumer, and government groups (*id.* 9a), was a direct result of the 1998 House Conference Report directing HUD to issue a policy statement on the subject within 90 days. (*Id.* at 14a.) The court recognized that the 2001 Policy Statement merely clarifies and is consistent with the 1999 Policy Statement. (*Id.* 12a.) And both Policy Statements, the court noted, were published in the FEDERAL REGISTER. (*Id.* 14a.) Finally, the Ninth Circuit noted that in Section 19(a) Congress gave HUD the authority to "interpret" RESPA, that Congress intended such interpretations to be binding under Section 19(b)'s good faith compliance safe harbor, and that HUD's Policy Statements qualify for that safe harbor. (*Id.*)

Having concluded that HUD's Policy Statements set forth the governing standard for determining whether mortgage broker compensation violates Section 8, the Ninth Circuit held that the district court properly granted summary judgment to Banc One because it was undisputed that HUD's two-part test was satisfied in Schuetz's transaction. (*Id.* 17a.) The Ninth Circuit explained that, with respect to part one of the test, the evidence was undisputed that "Schuetz's mortgage broker provided her a host of compensable ... services," and under part two of the test, it was undisputed that "the broker's total compensation, including direct as well as indirect fees, was consistent with local practice and reasonably related to the value that [the broker] contributed to Schuetz's transaction." (*Id.*)

Recognizing that the same individualized examination performed by the district court under the HUD test in the Schuetz transaction would have to be repeated for every putative class member's loan transaction, the Ninth Circuit held that "the district court did not abuse its discretion in denying class certification." (*Id.*) The court reasoned "that individual issues predominate, and that a class action is not

superior," because "[y]ield spread premiums are not illegal per se, so whether they amount to a prohibited referral in any particular case depends upon the services provided by the broker and the total compensation paid for those services."[12] (*Id.*)

Judge Kleinfeld dissented, relying primarily on the Eleventh Circuit's decision in *Culpepper* (*id.* 18a), which has since been overruled by the Eleventh Circuit in light of HUD's 2001 Policy Statement. *Heimmermann,* 305 F.3d at 1264.

REASONS FOR DENYING THE PETITION

I. THE NINTH CIRCUIT'S OPINION IS CONSISTENT WITH THE DECISIONS OF OTHER COURTS OF APPEALS ADDRESSING DEFERENCE TO HUD'S POLICY STATEMENTS AND CLASS CERTIFICATION IN YIELD SPREAD PREMIUM CASES.

Attempting to portray the decision below as reaching an anomalous result, Schuetz all but ignores the paramount fact that the Ninth Circuit is consistent with the only two other courts of appeals (the Eleventh and the Eighth Circuits) to decide the same issue in analogous yield spread premium cases. Both the Eleventh and Eighth Circuits have held that HUD's interpretation in its 1999 and 2001 Policy Statements is entitled to judicial deference and that HUD's two-part

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[12] Schuetz makes too much out of the fact that the district court, in denying class certification, applied a test that focused, in part, on the intent of the broker and borrower, which is not part of the HUD test. (Pet. 15 n.11.) The district court, without the benefit of HUD's 1999 Policy Statement, applied a test used by a number of other district courts to reach a similar conclusion that individual issues predominate. (Pet. App. 69a-71a.) In its subsequent summary judgment order, the district court applied HUD's two-part test. (*Id.* 42a-47a.) As the court of appeals recognized, class certification is inappropriate under HUD's two-part test.

test requires a loan-specific analysis, which precluded class certification of materially identical claims that yield spread premiums violate Section 8 of RESPA.

Like the Ninth Circuit opinion below, the Eleventh Circuit in *Heimmermann* held that HUD's interpretation of Section 8 of RESPA, as set forth in the 1999 Policy Statement and clarified in the 2001 Policy Statement, was entitled to *Chevron* deference. *See* 305 F.3d at 1261. The Eleventh Circuit first recognized that RESPA "does not, by its plain language, speak to the standard for determining whether the payment of a [yield spread premium] violates the Act." *Id.* The Eleventh Circuit then pointed out that HUD's Policy Statements fall squarely within Congress's "express delegation of authority" to HUD to issue "interpretations" of RESPA. *Id.* at 1261-62. Because HUD was acting within its congressionally delegated interpretative authority, the Eleventh Circuit reasoned that *Chevron* deference was appropriate, even without notice-and-comment. *Id.* at 1262 (citing *Barnhart*, 122 S. Ct. at 1271; *Mead*, 533 U.S. at 231). The Eleventh Circuit also "reject[ed] the argument that the 2001 [Policy Statement] is due no deference because it is inconsistent with earlier expressions of HUD's position." *Id.* at 1262. *See id.* ("we cannot say that the official position of HUD on the present issue has been inconsistent").

Having concluded that HUD's interpretation "is within the realm of agency interpretations that carry force of law and are due broad deference," the Eleventh Circuit examined whether HUD's interpretation is consistent with congressional intent. *Id.* at 1262. The court reasoned that "[t]he test laid out in the 2001 [Policy Statement], which does ban fees in excess of what would be reasonable compensation for the broker's service, seems to fulfill [RESPA's] ultimate goal" of "'the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services.'" *Id.* at 1262 (quoting 12 U.S.C. § 2601(b)(2)). The court also noted that by requiring that a broker provide a certain number and

type of services HUD's test prevents "a payment to a broker who provides 'no, nominal, or duplicative work.'" *Id.* at 1264 n.8.

The Eleventh Circuit then turned to the question of class certification, concluding that application of HUD's test to the allegations in *Heimmermann* requires loan-specific analysis rendering a class action inappropriate under Rule 23. *Id.* at 1263. The court explained that under the HUD test

> the first step in assessing whether RESPA has been violated is to determine whether the broker has provided goods or services of the kind typically associated with a mortgage transaction.... If this first step is satisfied, the fact-finder must proceed to the second step: determining whether the total compensation paid to the broker is reasonably related to the total value of the goods or services actually provided.

Id. at 1263-64 (citation omitted). Application of HUD's test, the court recognized, renders class certification inappropriate because "it is necessary to determine whether compensable services were provided by the broker and whether the total amount of broker compensation was reasonable in light of the circumstances of each loan." *Id.* at 1264.

The Eleventh Circuit also expressly "overrule[d]" its prior decision in *Culpepper*. *See Heimmermann*, 305 F.3d at 1264. *Culpepper* is relied upon by both the dissent (Pet. App. 18a) and Schuetz. (Pet. 9, 23.) In *Heimmermann*, the Eleventh Circuit explained that in *Culpepper* it had found HUD's 1999 Policy Statement "ambiguous" and that HUD's 2001 Policy Statement "clarifies that ambiguity." 305 F.3d at 1262. The Eleventh Circuit thus concluded:

> [T]he substance of the 2001 [Policy Statement] compels a different result in this case than the result in *Culpepper III*. The 2001 [Policy Statement] explicitly rejects the foundation of *Culpepper III*: "neither Section 8(a) of RESPA nor the 1999 [Policy Statement] supports the

> conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed."

Id. at 1263 (quoting 66 FED. REG. at 53,055). The court recognized, "[t]hat we may have determined in *Culpepper III* that a different interpretation of RESPA (in our view) is better or more consistent with the statutory language does not require—or even allow—us to reject HUD's interpretation."[13] *Id.* at 1262. Thus, *Culpepper* is no longer good law in the Eleventh Circuit, and Judge Kleinfeld's statement in dissent that there is a "circuit split" (Pet. App. 18a) is now clearly no longer accurate, to the extent it ever was true.[14] Surprisingly, Schuetz refers to *Heimmermann* only once, in a footnote. (Pet. 9 n.8.)

In *Glover*, the Eighth Circuit also held that HUD's Policy Statements were entitled to deference, albeit under a slightly different rationale. Like the Ninth Circuit below and the Eleventh Circuit in *Heimmermann*, the Eighth Circuit recognized that Section 8 does not directly address the legality of yield spread premiums and that HUD's regulation

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[13] Schuetz's assertion (Pet. 9 n.8) that *Heimmermann* "conflict[s]" with the Eleventh Circuit's reading of RESPA in *Culpepper* is belied by the *Heimmermann* opinion itself. In *Heimmermann*, the same three judge panel that had decided *Culpepper* explained: "Our ruling in *Culpepper III* did not purport to rely squarely upon the plain language of Section 8 of RESPA, but rather upon an interpretation of RESPA's language and of the 'ambiguous' 1999 [Policy Statement]." 305 F.3d at 1261 (emphasis omitted). The court also noted that in *Culpepper* it had held that the 1999 Policy Statement carried "the force of a regulation." *Id.* at 1261 n.6 (citing *Culpepper*, 253 F.3d at 1327).

[14] There was really never a *true* conflict because the Eleventh Circuit in *Culpepper* had not had the opportunity to address HUD's 2001 Policy Statement. *See Glover*, 283 F.3d at 964 n.9.

implementing RESPA "simply mirrors" the statute, 283 F.3d at 961, and "continues the statutory ambiguity." *Id.* at 962. The Eighth Circuit then cited two independent lines of authority as supporting deference to HUD. First, the court cited *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 413-14 (1945) and its progeny—*Christensen v. Harris County*, 529 U.S. 576, 588 (2000); *Auer v. Robbins*, 519 U.S. 452, 461 (1997)—for the proposition that an agency's interpretation of its own ambiguous regulation is entitled to judicial deference. 283 F.3d at 962. The Eighth Circuit held, under this line of authority, that "HUD's Policy Statements interpreting its own ambiguous regulation are controlling authority unless they are plainly erroneous or inconsistent with the regulation or the purpose of RESPA." *Id.* Second, the Eighth Circuit held that deference is appropriate under *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944) because "HUD's Policy Statements ... pack sufficient power to persuade given HUD's specialized mission, experience and broad investigation into the consumer lending market." 283 F.3d at 962.

Like the Eleventh Circuit in *Heimmermann* and the Ninth Circuit in this case, the Eighth Circuit concluded that HUD's two-part test is consistent with the regulation and the purpose of RESPA. *See id.* at 964. The Eighth Circuit recognized, moreover, that the same interpretation urged by Schuetz here is contrary to RESPA, as it essentially reads the "permissive language of Section 8(c)" out of RESPA. *Id.* The result of this approach, the Eighth Circuit explained, would be to render yield spread premiums *per se* illegal, which Congress clearly did not intend. *See id.* ("In the context of the residential loan industry as it exists today, we have difficulty seeing many, if any, factual situations in which a [yield spread premium] could lawfully coexist with [plaintiff's] contentions"). The court further explained that under Schuetz's approach here "it is almost certain that at least some legitimate Section 8(c) activities now performed by

mortgage brokers will be left uncompensated" and "the present borrower/broker/lender relationship will disintegrate, at least for those buyers who must borrow above par in order to finance settlement services." *Id.* at 965. HUD's Policy Statements, the court concluded, are entitled to deference under either *Seminole Rock* or *Skidmore* because they "reflect a reasoned view of a responsible agency which is consistent with the statute and the regulation and which constitutes a body of experience and informed judgment that this court may look to as determinative authority." *Id.* at 962-63.

Having decided that it must defer to HUD's interpretation, the Eighth Circuit went on to hold that class treatment was inappropriate. Applying HUD's two-part test to the allegations in that case, the Eighth Circuit reasoned that "loan-specific analysis is required in determining whether the payment of a [yield spread premium] is based upon services rendered or an illegal referral." *Id.* at 966.

In sum, the Ninth Circuit's opinion below is consistent with the only two other circuits to address deference to HUD's Policy Statements and class certification in materially identical cases challenging yield spread premiums under Section 8 of RESPA.[15] The courts of appeals have uniformly

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[15] Federal district court decisions around the country are also uniform in holding that HUD's interpretation is entitled to deference and that application of HUD's two-part test raises transaction specific inquiry that precludes class certification in analogous cases challenging yield spread premiums under Section 8 of RESPA. Approximately 50 federal district courts around the nation have denied class certification in analogous cases, some of which predate HUD's Policy Statements. Subsequent to HUD's 2001 Policy Statement, every court has deferred to HUD and denied class certification in such cases. A number of district courts have also granted summary judgment to lenders where the facts were undisputed that HUD's two-part test was satisfied. Conversely, there is no authority anywhere in the country to support Schuetz's arguments regarding HUD's test. Schuetz's arguments have been rejected by every court to consider them. (*See* Appellee Banc One's C.A. Brief at 20-21, 48-50 (citing cases).)

concluded that HUD's 2001 Policy Statement is a lawful and reasonable interpretation of Section 8 of RESPA and requires denial of class certification under the circumstances and allegations presented here. Schuetz does not dispute that there is no circuit split. This Court's review is unwarranted.

II. THE NINTH CIRCUIT'S OPINION IS CONSISTENT WITH THIS COURT'S DEFERENCE PRECEDENT.

A. Given the complete absence of any conflict among the courts of appeals on the precise question presented by the decision below, Schuetz stretches to present more abstract questions about the Ninth Circuit's decision to defer to HUD. Schuetz asks the Court to grant *certiorari* to review whether the Ninth Circuit erred in its case-specific, fact-bound application of this Court's existing deference precedent. (Pet. at 13.) Schuetz even goes so far as to suggest that the Court review the factual record and determine whether the Ninth Circuit's affirmance of the discretionary denial of class certification and grant of summary judgment were supported by the record.[16] (Pet. at 7, 11.) The Court does not grant *certiorari* to correct errors. Many of these same arguments that Schuetz raises here were previously presented to the Court in a petition for *certiorari* of the Eighth Circuit's

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[16] Schuetz asserts that the yield spread premium was not for services, citing the dissent and claiming that there was no evidence that the yield spread premium was used to offset up-front costs. (Pet. 10-11.) This argument ignores the fact that whether the yield spread premium constituted payment for services is determined by applying HUD's two-part test and that both the district court and Ninth Circuit found that test was satisfied by the undisputed evidence. (Pet. App. 17a, 44a-47a.) That the yield spread premium offset Schuetz's closing costs is further evidenced, as the Ninth Circuit recognized, by the undisputed fact that Schuetz's broker "would not have originated her loan for only the direct fees that she personally paid up front" (*Id.* 17a), which is supported by the record. (Supp. Exc. 178, 190-91.)

Glover decision, where the petitioner was represented by many of the same counsel who represent Schuetz here. This Court denied the *Glover* petition earlier this Term. This case is no more worthy of this Court's plenary review than *Glover*. Nothing has changed.

B. Schuetz's arguments that the Ninth Circuit erred in affording *Chevron* deference to HUD's Policy Statements do not support granting the Petition here. The Ninth Circuit correctly deferred to HUD. *See Chevron U.S.A. Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 842-44 (1984) (where Congress has delegated to an agency the authority to implement a statute and the statute is silent or ambiguous on the precise question at issue, the agency's reasonable interpretation of the statute is entitled to controlling weight). Contrary to Schuetz's assertion[17] (Pet. 16, 17), RESPA does not address the precise question at issue; the statute does not specify how to determine whether a lender payment to a mortgage broker falls within the prohibition of referral fees under Section 8(a) or the permissive language for services rendered under Section 8(c). Indeed, as noted previously, RESPA was enacted in 1974, long before the advent of mortgage brokers, wholesale lenders, and yield spread premiums, which did not exist until the 1980s. This statutory ambiguity was recognized by the Ninth Circuit below, the Eighth and Eleventh Circuits, and the 1998 Conference Report directing HUD to clarify its position on the issue.

Nor can it be disputed that in Section 19(a) Congress delegated to HUD broad authority to implement RESPA and that HUD's Policy Statements fall squarely within this delegated authority. Schuetz's argument that HUD's interpretation is not entitled to *Chevron* deference because the

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[17] Schuetz undermines her own argument that Section 8 is clear and unambiguous by relying elsewhere in the Petition on legislative history (Pet. 3-4) in an effort to support her interpretation. As shown *infra*, the legislative history likewise does not support Schuetz's interpretation.

Policy Statements were not subject to notice-and-comment rulemaking (Pet. 21) completely misses the mark. This Court recently reaffirmed that notice-and-comment rulemaking is not necessary to invoke *Chevron* deference. *See Mead*, 533 U.S. at 230-31; *Barnhart*, 122 S. Ct. at 1271-72. Schuetz's argument ignores Section 19(a), in which Congress expressly delegated to HUD the authority to issue "interpretations" of RESPA, in addition to notice-and-comment "rules and regulations." Congress's intent that HUD's interpretations carry force of law, *see Mead*, 533 U.S. at 226-27, is evidenced further by the statutory safe harbor in Section 19(b) for good faith compliance with any HUD "rule, regulation, or interpretation." HUD acted squarely within that congressionally delegated authority, *see id.*, when it issued the Policy Statements. HUD expressly invoked its interpretative authority under Section 19(a) and followed all the formalities, including publication in the FEDERAL REGISTER, necessary to make the Policy Statements binding under RESPA's good faith safe harbor.[18] HUD also consulted with interested parties, including consumer groups. *See* 66 FED. REG. at 53,052 (RA 36a); 64 FED. REG. at 10,084 (RA 18a); HUD News Release No. 01-105 (Oct. 15, 2001), www.hud.gov/news/morereleases.cfm.[19]

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[18] Contrary to Schuetz's misplaced assertions (Pet. 18-19), HUD's Policy Statements are nothing like the ruling letters at issue in *Mead*, which were issued from 46 separate Customs offices at a rate of 10,000 to 15,000 a year, and were not binding on anyone other than the parties to the particular transaction. 533 U.S. at 233. Moreover, in *Mead* there was no comparable delegation to the agency of the express authority to interpret the statute. *Id.* at 221-22.

[19] Schuetz's argument that HUD should have followed the procedures necessary to create an "exemption" from Section 8 is misplaced. (Pet. 17-18, 21.) The authority to create additional exemptions from Section 8 liability provided in Section 8(c)(5) in no way clashes with HUD's authority to act pursuant to Section 19(a) to fill in gaps left by Congress in the application of the exemption from liability already set forth in

In *Ford Motor Credit Co. v. Milhollin*, 444 U.S. 555 (1980), this Court afforded binding deference to an agency interpretation directly analogous to HUD's Policy Statements here. In *Milhollin*, the Court held that Federal Reserve Board staff interpretations of the Truth in Lending Act and its implementing regulations (Regulation Z) were "dispositive" unless "demonstrably irrational." *Id.* at 565. The Court held that "*Congress has conferred special status upon official staff interpretations*," *id.* at 566 n.9, by creating a safe harbor in TILA for a "*good-faith compliance with a* 'rule, regulation, or *interpretation*' " of the Board or its staff. *Id.* at 567 (emphasis added). The Court concluded that the statutory good faith safe harbor, which is materially identical to Section 19(b) of RESPA, "signals an *unmistakable congressional decision to treat administrative* rulemaking and *interpretation under TILA as authoritative*." *Id.* at 567-68 (emphasis added). Like the HUD Policy Statements here, the staff interpretations not only interpreted the statute, but also the Board's own regulations, and thus were particularly entitled to deference. *Id.* at 566 (citing *Seminole Rock*, 325 U.S. at 413-14). "Congress delegated broad administrative lawmaking power to the Federal Reserve Broad when it framed TILA. The Act is best construed by those who gave it substance in promulgating regulations thereunder." *Id.* at 566. The Court pointed out that the Board and its staff are better suited than the courts to make policy judgments about the implementation of TILA given their expertise on complex consumer credit transactions, *see id.* at 559-60, 568-69, which is similar to HUD's expertise on real estate settlement. The Court

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Section 8(c)(2). Moreover, HUD's Policy Statements do not exempt lender payments to brokers from the prohibitions of Section 8. A lender payment to a mortgage broker may still violate Section 8 if HUD's test is not satisfied.

also noted that the staff interpretations were the official position of the Board and were published in the FEDERAL REGISTER, *id.* at 567 & n.10, just as HUD's Policy Statements are here.

Finally, contrary to Schuetz's unsupported assertions (Pet. 16, 17), HUD's test is consistent with RESPA's purpose. RESPA's legislative history makes clear that Section 8 was intended to prohibit payments to parties who perform "no services ... other than placing a telephone call...," S. Rep. No. 93-866 (1974), *reprinted in* 1974 U.S.C.C.A.N. 6546, 6551, not payments such as "commissions" (*i.e.*, percentage-based payments) to parties who "perform substantial services" including "all of the work that a branch office ... would otherwise have to perform." *Id.* at 6552. *See id.* at 6556. The legislative history also provides that the "excess of the reasonable value of the ... services performed ... may be considered a kick-back or referral fee proscribed by Section [8]." *Id.* at 6551. By ensuring that mortgage brokers perform a minimum number and type of services and that their compensation is reasonable, HUD's two-part test is consistent with this legislative history and RESPA's ultimate goal of preventing "unnecessarily high" settlement charges. 12 U.S.C. § 2601(a) (Pet. App. 76a). At the same time, HUD's test retains the consumer *benefits* of lender payments to brokers, by ensuring that consumers have the flexibility to reduce up-front costs, thereby fostering homeownership.

In fact, it is Schuetz's interpretation which is contrary to the statute. Schuetz reads Section 8(c) out of the Act and renders lender payments *per se* illegal, which would make it more difficult for millions of Americans to realize the goal of homeownership. *See Glover*, 283 F.3d at 965. Indeed, as the Ninth Circuit recognized, Schuetz focuses almost exclusively on "one element of § 8(a) but does not say anything about § 8(c)(2) or its intersection with § 8(a)." (Pet. App. 16a.)

C. Nor does Schuetz's more extravagant argument—that the Ninth Circuit's opinion below is inconsistent with this Court's decision in *Adams Fruit Co. v. Barrett*, 494 U.S. 638 (1990)—support the Petition. *Adams Fruit*—now the centerpiece of Schuetz's Petition—was a mere foornote in her reply brief in the court of appeals below. Contrary to Schuetz's assertion, unlike the agency regulation at issue in *Adams Fruit*, HUD's Policy Statements do not encroach upon a statutory private right of action or exceed HUD's congressionally delegated authority. In *Adams Fruit*, this Court held that no deference was due a Department of Labor regulation which prevented injured migrant workers from availing themselves to the private right of action under the Migrant and Seasonal Agricultural Workers Protection Act ("AWPA") if the workers were entitled to state workers' compensation benefits. *See id.* at 649. The Court concluded that the regulation was contrary to the AWPA's provision providing a private right of action, which contained no state exclusivity language. *See id.* The Court held that the agency had no authority to limit the scope of the plain language of the statute's private remedy to injured workers who were not entitled to a remedy under state workers' compensation law. *See id.* at 649-50.

Unlike the agency in *Adams Fruit*, HUD acted squarely within its congressionally delegated authority in issuing its Policy Statements. Indeed, HUD issued the 1999 Policy Statement as a direct result of a congressional command to the Department to clarify the lawfulness of lender payments to mortgage brokers. And unlike the regulation in *Adams Fruit*, HUD's Policy Statements do not interpret or limit who can avail themselves to the private remedy provision found in Section 8(d)(5) of RESPA. Pursuant to HUD's congressionally delegated authority under Section 19(a), and the specific directive in the 1998 House Conference Report, the Policy Statements interpret Sections 8(a) and (c) of RESPA, and set forth the legal standard for evaluating the legality of

lender-paid mortgage broker compensation under those sections. Nor do HUD's Policy Statements interpret Fed. R. Civ. P. 23 on class actions, as Schuetz contends. (Pet. 15, 23.) The mere fact that HUD's two-part test requires a loan-specific analysis of the allegations alleged by Schuetz does not mean that HUD has exceeded its authority. A district court must necessarily look to the applicable liability standard in determining whether claims can be properly adjudicated and managed on a class-wide basis under Rule 23. *See General Tel. Co. v. Falcon*, 457 U.S. 147, 160 (1982). The Ninth Circuit simply recognized this unremarkable legal principle.

The other cases cited by Schuetz are distinguishable on the same basis as *Adams Fruit*.[20] *See Ragsdale v. Wolverine World Wide, Inc.*, 535 U.S. 81, __, 122 S. Ct. 1155, 1161-62 (2002) (Department of Labor regulation that required employers who failed to provide notice of unpaid leave to either provide 12 additional weeks or face automatic liability under the Family and Medical Leave Act was contrary to the statute and beyond the agency's authority because it relieved employee of statutory burden to prove impairment of rights and resulting prejudice); *SEC v. Sloan*, 436 U.S. 103, 111-17 (1978) (SEC's suspension of trading for more than a year through issuance of a series of consecutive orders suspending trading for 10 days without notice and an opportunity to be heard was contrary to language and structure of the statute

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[20] The courts of appeals decisions cited by Schuetz are also distinguishable on largely the same grounds. *See, e.g., Dantran, Inc. v. United States Dep't of Labor*, 246 F.3d 36 (1st Cir. 2001) (agency determined eligibility for attorney's fees under the Equal Access to Justice Act); *Arapahoe County Pub. Airport Auth. v. FAA*, 242 F.3d 1213 (10th Cir.), *cert. denied*, 122 S. Ct. 664 (2001) (agency determined preclusive effect of state court decision under full faith and credit principals); *Fabil Mfg. Co. v. United States*, 237 F.3d 1335 (Fed. Cir. 2001) (agency established burden of proof in judicial proceedings); *American Airlines, Inc. v. Dep't of Trans.*, 202 F.3d 788 (5th Cir.), *cert. denied*, 530 U.S. 1274 (2000) (same as *Arapahoe County*).

which only authorized Commission to suspend trading for 10 days once for a single violation); *Federal Maritime Comm'n v. Seatrain Lines, Inc.*, 411 U.S. 726, 744-45 (1973) (Maritime Commission's approval of acquisition agreement for antitrust exemption under the Shipping Act was contrary to clear intent of Congress in statutory scheme and legislative history limiting Commission's jurisdiction to agreements with ongoing responsibilities requiring continuing Commission supervision). Moreover, the decisions cited by Schuetz are readily distinguishable as they involve different statutes with varying substantive provisions, subject matter, congressional intent, and delegations of agency authority, as well as different agency interpretations and expertise; and they analyze distinct competing policy choices.

There is no merit to Schuetz's attempt to expand *Adams Fruit* into a holding that *Chevron* is inapplicable where a statute creates a private right of action. This Court has applied *Chevron* deference to numerous cases which involved private causes of action under federal statutes. *See, e.g.*, *Auer*, 519 U.S. at 457-63 (private action to recover overtime wages under the Fair Labor Standards Act). Schuetz's argument would undermine the national uniformity of federal law, because it would produce different standards of liability depending upon whether the proceeding involved was an agency enforcement action or private litigation. In sum, given that the Ninth Circuit's decision is consistent with the Court's apposite precedent, there is no reason for this Court to exercise its plenary review.

D. Schuetz's request that the Court review whether HUD's Policy Statements are due deference under the Court's opinion in *Skidmore* is plainly without merit. As noted above, the Eighth Circuit in *Glover* held that HUD's Policy Statements were entitled to deference under *Seminole Rock* or, alternatively, under *Skidmore*. Although Banc One presented these same alternative bases for deferring to HUD's Policy Statements below, the Ninth Circuit never reached the issue,

deciding instead to apply *Chevron* deference. Since the court below never addressed *Skidmore* deference, there is clearly no basis for accepting review on that issue. And the fact that the Ninth Circuit did not address the related and alternative grounds for deference under *Seminole Rock* and *Skidmore* also undermines granting review of the *Chevron* question. Simply put, this is neither the right case or time to review the deference question.

Schuetz's *Skidmore* argument (Pet. 22) is wholly premised on the notion that HUD's interpretation of Section 8 has been inconsistent over time. This is mere wishful thinking. HUD's 2001 Policy Statement simply clarified its previous interpretation. "HUD has consistently advised that the issue under RESPA is whether the compensation to a mortgage broker ... is reasonably related to the value of the ... services actually performed." 64 FED. REG. at 10,083 (RA 14a). Nothing in the language of any of the sources cited by Schuetz (Pet. 23-24) remotely conflicts with HUD's current Policy Statements. Schuetz's arguments are rebutted by any fair reading of HUD's Statements themselves, and again provide no basis for this Court's review.

Schuetz's Petition does not even address an alternative reason to defer to HUD's Policy Statements under *Seminole Rock* as HUD's interpretation of its own ambiguous regulations. HUD's 1999 Policy Statement is clearly HUD's interpretation of its own regulations and the 2001 Policy Statement is also an interpretation of HUD's 1999 Policy Statement. The kind of deference set forth in *Seminole Rock* and reaffirmed in *Auer*—that the entity most qualified to clarify an ambiguity in an administrative pronouncement is the entity that promulgated it—also applies fully in this case. HUD is obviously in the best position to clarify its own regulations and Policy Statements. The Petition should be denied.

E. Finally, this case is also a poor vehicle to resolve the issues presented by the Petition. First, the lower courts—including the district court in this case in denying class certification—were with rare exception reaching the same result prior to HUD's Policy Statements. Second, HUD's notice-and-comment regulations provide independent support for the Ninth Circuit decision. HUD's regulations define the term "referral" under Section 8(a) as a payment which "has the effect of *affirmatively influencing* the selection by any person of a provider of a settlement service...." 24 C.F.R. § 3500.14(f)(1) (emphasis added). Banc One argued below (*see* Appellee's C.A. Brief at 45) that the regulation provides an independent basis for awarding summary judgment because it was undisputed that the broker selected Banc One, rather that some other lender, because of factors unrelated to the yield spread premium.[21] (Supp. Exc. at 190.) Indeed, courts have granted summary judgment to wholesale lenders in analogous yield spread premium cases where plaintiffs failed to establish this essential element of a Section 8(a) claim. *See, e.g.*, *Barbosa v. Target Mortgage Corp.*, 968 F. Supp. 1548, 1557-58 (S.D. Fla. 1997). Banc One also argued below (*see* Appellee's C.A. Brief at 53) that the HUD regulation renders class treatment inappropriate because the fact finder would have to examine the reasons that some 700 brokers selected Banc One to fund thousands of putative class member loans. Again, these alternative grounds for the Ninth Circuit opinion undermine the Petition, and demonstrate that this case is not an appropriate vehicle to review the question presented by Schuetz.

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[21] The Ninth Circuit appeared to take note of this undisputed evidence. (*See* Pet. App. 4a ("According to Home Mortgage, loans are selected based on the lender's service, turnaround time, ability to make the required funds available, reputation in the community, level of professionalism, reputation with the banking department, competitive rates, underwriting flexibility, and the availability of products").)

III. THE PETITION DOES NOT PRESENT AN IMPORTANT QUESTION FOR REVIEW.

Contrary to Schuetz's contentions (Pet. 27), the Petition does not present important questions of law or policy which warrant review by this Court. First, as there is no split in the circuit courts on the issues presented, and as the Ninth Circuit's deference analysis is in full accord with this Court's prior precedent, the Petition does not present the kind of case where review is necessary to resolve unsettled jurisprudence.

Schuetz essentially wants the federal courts through piecemeal litigation to make policy judgments about an industry practice—lender paid compensation to mortgage brokers—where that policy judgment has been properly delegated to and resolved by the politically accountable arm of the executive branch. Schuetz implies that consumers would benefit if this case were reviewed and a contrary rule of liability rendering yield spread premiums *per se* illegal were adopted. Not only is this assertion unsupported by the record, it is contrary to explicit findings by HUD. By using yield spread premiums to pay some or all of the compensation to mortgage brokers for their work in originating home mortgage loans, borrowers may (by choice or necessity) limit the amount of up-front cash required to obtain a mortgage loan. As such, yield spread premiums provide consumers with flexibility in structuring mortgage financing transactions which ultimately fosters homeownership.

Finally, Schuetz's assertion that the Ninth Circuit's decision leaves borrowers without a remedy and permits lenders to escape liability is totally unfounded. As the Eighth Circuit pointed out in *Glover,* class-wide relief is not required to ensure that RESPA is properly enforced because "Congress has guaranteed legal representation under RESPA by permitting attorneys fees and costs as part of each allowable recovery." 283 F.3d at 965. As such, "a class action is not necessary for justice to be done." *Id.*

CONCLUSION

For the foregoing reasons, the petition for a writ of *certiorari* should be denied.

Respectfully submitted,

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APPENDICES

APPENDIX A

DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT
24 CFR Part 3500

[Docket No. FR–4450–N–01]

RIN 2502–AH33

Real Estate Settlement Procedures Act (RESPA) Statement of Policy 1999–1 Regarding Lender Payments to Mortgage Brokers

AGENCY: Office of the Assistant Secretary for Housing–Federal Housing Commissioner, HUD.

ACTION: Statement of Policy 1999–1.

SUMMARY: This Statement of Policy sets forth the Department of Housing and Urban Development's position on the legality of lender payments to mortgage brokers in connection with federally related mortgage loans under the Real Estate Settlement Procedures Act ("RESPA") and HUD's implementing regulations. While this statement satisfies the Conferees' directive in the Conference Report on the 1999 HUD Appropriations Act that the Department clarify its position on this subject, HUD believes that broad legislative reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and the Truth in Lending Act (TILA) for industry and consumers alike. Statutory changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the

costs associated with home-secured credit transactions and providing creditors and mortgage brokers with clearer rules. Such an approach is far preferable to piecemeal actions.

EFFECTIVE DATE: This Statement of Policy is effective March 1, 1999.

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SUPPLEMENTARY INFORMATION: This Preamble to the Statement of Policy includes descriptions of current practices in the industry. It is not intended to take positions with respect to the legality or illegality of any practices; such positions are set forth in the Statement of Policy itself.

I. Background

A. General Background

The Conference Report on the Departments of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999 (H.R. Conf. Rep. No. 105-769, 105th Cong., 2d Sess. 260 (1998)) (FY 1999 HUD Appropriations Act) directs HUD to clarify its position on lender payments to mortgage brokers within 90 days after the enactment of the FY 1999 HUD Appropriations Act on October 21, 1998. The Report states that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually

performed to be violations of [Sections 8](a) or (b) of the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA)]" (*Id.*). The Report also states that the Conferees "are concerned about the legal uncertainty that continues absent such a policy statement" and "expect HUD to work with representatives of industry, Federal agencies, consumer groups, and other interested parties on this policy statement" (*Id.*).

This issue of lender payments, or indirect fees, to mortgage brokers has proven particularly troublesome for industry and consumers alike. It has been the subject of litigation in more than 150 cases nationwide (see additional discussion below). To understand the issue and HUD's position regarding the legality of these payments requires background information concerning the nature of the services provided by mortgage brokers and their compensation, as well as the applicable legal requirements under RESPA.

During the last seven years, HUD has conducted three rulemakings respecting mortgage broker fees. These rulemakings first addressed definitional issues and issues concerning disclosure of payments to mortgage brokers in transactions covered under RESPA. (*See* 57 FR 49600 (November 2, 1992); 60 FR 47650 (September 13, 1995).) Most recently in a regulatory negotiation (see 60 FR 54794 (October 25, 1995) and 60 FR 63008 (December 8, 1995)) and then a proposed rule (62 FR 53912 (October 16, 1997)), HUD addressed the issue of the legality of payments to brokers under RESPA. In the latter, HUD proposed that payments from lenders to mortgage brokers be presumed legal if the mortgage broker met certain specified conditions, including disclosing its role in the transaction and its total compensation through a binding contract with the borrower. This rulemaking is pending.

In July 1998, HUD and the Board of Governors of the Federal Reserve delivered to Congress a joint report con-

taining legislative proposals to reform RESPA and the Truth in Lending Act. If the proposals in this reform package were to be adopted, the disclosure and legality issues raised herein would be resolved for any mortgage broker following certain of the proposed requirements, and consumers would be offered significant new protections.

B. Mortgage Brokerage Industry

When RESPA was enacted in 1974, single family mortgages were largely originated and held by savings and loans, commercial banks, and mortgage bankers. During the 1980's and 1990's, the rise of secondary mortgage market financing resulted in new wholesale and retail entities to compete with the traditional funding entities to provide mortgage financing. This made possible the origination of loans by retail entities that worked with prospective borrowers, collected application information, and otherwise processed the data required to complete the mortgage transaction. These retail entities generally operated with the intent of developing the origination package, and then immediately transmitting it to a wholesale lender who funded the loan. The rise in technology permitted much more effective and faster exchange of information and funds between originators and lenders for the retail transaction.

Entities that provide mortgage origination or retail services and that bring a borrower and a lender together to obtain a loan (usually without providing the funds for loans) are generally referred to as "mortgage brokers." These entities serve as intermediaries between the consumer and the entity funding the loan, and currently initiate an estimated half of all home mortgages made each year in the United States. Mortgage brokers generally fit into two broad categories: those that hold themselves out as representing the borrower in shopping for a loan, and those that simply offer loans as do other retailers of loans. The first type may have an agency relationship with the borrower and, in some states, may be

found to owe a responsibility to the borrower in connection with the agency representation. The second type, while not representing the borrower, may make loans available to consumers from any number of funding sources with which the mortgage broker has a business relationship.

Mortgage brokers provide various services in processing mortgage loans, such as filling out the application, ordering required reports and documents, counseling the borrower and participating in the loan closing. They may also offer goods and facilities, such as reports, equipment, and office space to carry out their functions. The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders.

Mortgage brokers vary in their methods of collecting compensation for their work in arranging, processing, and closing mortgage loans. In a given transaction, a broker may receive compensation directly from the borrower, indirectly in fees paid by the wholesaler or lender providing the mortgage loan funds, or through a combination of both.

Where a broker receives direct compensation from a borrower, the broker's fee is likely charged to the borrower at or before closing, as a percentage of the loan amount (*e.g.*, 1% of the loan amount) and through direct fees (such as an application fee, document preparation fee, processing fee, etc.).

Brokers also may receive indirect compensation from lenders or wholesalers. Such indirect fees may be referred to as "back funded payments," "servicing release premiums," or

"yield spread premiums." These indirect fees paid to mortgage brokers may be based upon the interest rate of each loan entered into by the broker with the borrower. These fees have been the subject of much contention and litigation. Another method of indirect compensation, also the subject of significant controversy and uncertainty, is "volume-based" compensation. This generally involves compensation to a mortgage broker by a lender based on the volume of loans that the mortgage broker delivers to the lender in a fixed period of time. The compensation may come in the form of: (1) a cash payment to the broker based on the amount of loans the broker delivers to the lender in excess of a "threshold" or "floor amount"; or (2) provision of a lower "start rate" (often called a discount) for such loans; the compensation to the broker results from the difference in yield between the "start rate" and the loan rate. Volume based compensation may be received at settlement or well after a particular loan has closed.

Payments to brokers by lenders, characterized as yield spread premiums, are based on the interest rate and points of the loan entered into as compared to the par rate offered by the lender to the mortgage broker for that particular loan (e.g., a loan of 8% and no points where the par rate is 7.50% will command a greater premium for the broker than a loan with a par rate of 7.75% and no points).[1] In determining the price of a loan, mortgage brokers rely on rate quotes issued by lenders, sometimes several times a day. When a lender agrees to purchase a loan from a broker, the broker receives the then applicable pricing for the loan based on the difference between the rate reflected in the rate quote and the rate of the loan entered into by the borrower. In some cases, the broker can increase its revenues by arranging a loan with the

[1] The term "par rate" refers to the rate offered to the broker (through the lender's price sheets) at which the lender will fund 100% of the loan with no premiums or discounts to the broker.

consumer at a particular rate and then, based on market changes or other factors which decrease the par rate, increase his or her fees. Some consumers allege that the compensation system for brokers results in higher loan rates for borrowers and/or that this compensation system is illegal under RESPA.

Lender payments to mortgage brokers may reduce the up-front costs to consumers. This allows consumers to obtain loans without paying direct fees themselves.[2] Where a broker is not compensated by the consumer through a direct fee, or is partially compensated through a direct fee, the interest rate of the loan is increased to compensate the broker or the fee is added to principal. In any of the compensation methods described, all costs are ultimately paid by the consumer, whether through direct fees or through the interest rate.

C. Coverage of This Policy Statement

HUD's RESPA rules, found at 24 CFR part 3500 (Regulation X), define a mortgage broker to be "a person (not an employee or exclusive agent of a lender) who brings a borrower and lender together to obtain a federally-related mortgage loan, and who renders * * * 'settlement services'" (24 CFR 3500.2(b)). In table funding, mortgage brokers may process and close loans in their own names. However, at or about the time of settlement, they transfer these loans to the lender, and the lender simultaneously advances the monies to fund the loan. In transactions where mortgage brokers function as intermediaries, the broker also provides loan origination services, but the loan funds are provided by the lender and the loan is closed in the lender's name.

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[2] In many instances, these loans are called "no cost" or "no fee" loans. This terminology, however, may prove confusing because in such cases the costs are still paid by the borrower through a higher interest rate on the loan or by adding fees to principal. HUD's regulations implementing RESPA use the name "no cost" or "no point" loans consistent with industry practice.

In other cases, mortgage brokers may originate and close loans in their own name using their own funds or warehouse lines of credit, and then sell the loans after settlement in the secondary market. In such transactions, mortgage brokers effectively act as lenders under HUD's RESPA rules. Accordingly, the transfer of the loan obligation by, and payment to, these brokers after the initial funding is outside of RESPA's coverage under the secondary market exemption, found at 24 CFR 3500.5(b)(7), which states that payments to and from other loan sources following settlement are exempt from disclosure requirements and Section 8 restrictions. HUD's rule provides that in determining what constitutes a *bona fide* transfer in the secondary market, HUD considers the real source of funding and the real interest of the funding lender. (24 CFR 3500.5(b)(7).)

Because this Statement of Policy focuses on the legality of lender payments to mortgage brokers in transactions subject to RESPA, the coverage of this statement is restricted to payments to mortgage brokers in table-funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as exempt from RESPA under the secondary market exemption.

D. RESPA and Its Legislative History

In enacting RESPA, Congress sought to protect the American home-buying public from unreasonably and unnecessarily inflated prices in the home purchasing process (S. Rep. No. 93–866 (1974) *reprinted in* 1974 U.S.C.C.A.N. 6548). Section 2 of the Act provides:

> "significant reforms in the real estate settlement process are needed to insure that consumers throughout the Nation are provided with greater and more timely information on the nature and costs of the settlement

process and are protected from unnecessarily high settlement charges caused by certain abusive practices that have developed in some areas of the country. * * * It is the purpose of this act to effect certain changes in the settlement process for residential real estate that will result— in more effective advance disclosure to home buyers and sellers of settlement costs; [and]

(2) In the elimination of kickbacks or referral fees that tend to increase unnecessarily the costs of certain settlement services. * * *" 12 U.S.C. 2601.

Section 4(a) of RESPA requires the Secretary to create a uniform settlement statement which "shall conspicuously and clearly itemize all charges imposed upon the borrower and all charges imposed upon the seller in connection with the settlement" (12 U.S.C. 2603(a)).

Section 5(c) of RESPA requires the provision of a "good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement as prescribed by the Secretary" (12 U.S.C. 2604(c)).

Section 8(a) of RESPA, prohibits any person from giving and any person from accepting any fee, kickback, or other thing of value pursuant to any agreement or understanding that business shall be referred to any person. (See 12 U.S.C. 2607(a).) Section 8(b) also prohibits anyone from giving or accepting any portion, split, or percentage of any charge made or received for the rendering of a settlement service other than for services actually performed. (12 U.S.C. 2607(b).) Section 8(c) of RESPA provides, however, that nothing in Section 8 shall be construed as prohibiting the payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or services actually performed. (12 U.S.C. 2607(c)(2).)

Under Section 19 of RESPA, HUD is authorized to issue rules, establish exemptions, and make such interpretations as is necessary to implement the law. (12 U.S.C. 2618(a).)

RESPA's legislative history refers to HUD–VA Reports and subsequent hearings by the Housing Subcommittee as defining "major problem areas that [had to] be dealt with if settlement costs are to be kept within reasonable bounds." (S. Rep. No. 93–866, at 6547.) One "major problem area" identified was the "[a]busive and unreasonable practices within the real estate settlement process that increase settlement costs to home buyers without providing any real benefits to them." Another major concern was "[t]he lack of understanding on the part of most home buyers about the settlement process and its costs, which lack of understanding makes it difficult for a free market for settlement services to function at maximum efficiency."

The legislative history reveals that Congress intended RESPA to guard against these unreasonable and excessive settlement costs in two ways. Under Section 4, Congress sought to "mak[e] information on the settlement process available to home buyers in advance of settlement and requir[e] advance disclosures of settlement charges." (S. Rep. 93–866, at 6548.) The Senate Report explained that "home buyers who would otherwise shop around for settlement services, and thereby reduce their overall settlement costs, are prevented from doing so because frequently they are not apprised of the costs of these services until the settlement date or are not aware of the nature of the settlement services that will be provided."

Under Section 8, Congress sought to eliminate what it termed "abusive practices"—kickbacks, referral fees, and unearned fees. In enacting these prohibitions, Congress intended that "the costs to the American home buying public will not be unreasonably or unnecessarily inflated." (S. Rep. 93-866 at 6548.) In describing the Section 8 provisions, the

Senate Report explained that RESPA "is intended to prohibit all * * * referral fee arrangements whereby any payment is made or 'thing of value' is provided for the referral of real estate settlement business." (S. Rep. 93–866, at 6551.)

The legislative history adds that "[t]o the extent the payment is in excess of the reasonable value of the goods provided or services performed, the excess may be considered a kickback or referral fee proscribed by Section [8]." (S. Rep. 93-866, at 6551.) The Senate Report states that "reasonable payments in return for services actually performed or goods actually furnished" were not intended to be prohibited (Id).[3] It also provided that "[t]hose persons and companies that provide settlement services should therefore take measures to ensure that any payments they make or commissions they give are not out of line with the reasonable value of the services received." (*Id.*)

The Department has consistently held that the prohibitions under Section 8 of RESPA cover the activities of mortgage brokers, because RESPA applies to the origination, processing, and funding of a federally related mortgage loan. This became an issue when, in 1984, the 6th Circuit Court of Appeals held that in applying Section 8 as a criminal statute, the definition of settlement services did not clearly extend to the making of a mortgage loan. (*U.S.* versus *Graham Mortgage Corp.*, 740 F.2d 414 (6th Cir. 1984).) In 1992, Congress responded by amending RESPA to remove any doubt that, for purposes of RESPA, a settlement service includes the origination and making of a mortgage loan.

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[3] One of the examples of abusive activities listed in the legislative history that RESPA was intended to remedy is "a title insurance company [that] may give 10% or more of the title insurance premium to an attorney who may perform no services for the title insurance company other than placing a telephone call to the company or filling out a simple application." (S. Rep. 93-866, at 6551.) Accordingly, where insufficient services are provided, RESPA is intended to prohibit payment.

(Section 908 of the Housing and Community Development Act of 1992 (Pub. L. 102–550, approved October 28, 1992; 104 Stat. 4413). At the same time, Congress also specifically made RESPA applicable to second mortgages and refinancings. (*Id.*)

E. HUD's RESPA Rules

On November 2, 1992 (57 FR 49600), the Department issued a major revision of Regulation X, the rule interpreting RESPA. The rule defined the term "mortgage broker" for the first time. Under the rule, mortgage brokers are required to disclose direct and indirect payments on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (c).) Such disclosure must also be provided to consumers, as a final figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A (Instructions for Filling Out the HUD-1 and HUD-1A).) On the GFE and the settlement statement, lenderpaid mortgage broker fees must be shown as "Paid Outside of Closing" (P.O.C.), and not computed in arriving at totals. (See 24 CFR 3500.7(a)(2) and 24 CFR part 3500, Appendix A.) The 1992 rule treats mortgage brokers as settlement service providers whose fees are disbursed at or before settlement, akin to title agents, attorneys, appraisers, etc., whose fees are subject to disclosure and otherwise subject to RESPA, including Section 8.

The 1992 rule did not explicitly take a position on whether yield spread premiums or any other named class of back-funded or indirect fees paid by lenders to brokers are *per se* legal or illegal. By illustration, codified as Illustrations of Requirements of RESPA, Fact Situations 5 and 12 in Appendix B to 24 CFR part 3500, the 1992 rule specifically listed "servicing release premiums" and "yield spread premiums" as fees required to be itemized on the settlement statement. Although the 1992 rule specifically acknowledged the existence of such fees and provided illustrations of how

they were to be denominated on HUD disclosure forms, this requirement was intended to ensure their disclosure, but not to create a presumption of *per se* legality or illegality.

The anti-kickback, anti-referral fee and unearned fee provisions of RESPA are implemented by 24 CFR 3500.14. Regulation X repeats the Section 8 prohibitions against compensation for the referral of settlement service business and for the giving or accepting of any portion, split or percentage of any charge other than for services actually rendered. (24 CFR 3500.14(c).) Regulation X provides that a charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates the unearned fee prohibition. (See 24 CFR 3500.14(c).) Moreover, 24 CFR 3500.14(g)(1)(iv) clarifies that Section 8 of RESPA permits "[a] payment to any person of a *bona fide* salary or compensation or other payment for goods or facilities actually furnished or for services actually performed."

The Department's regulations provide, under 24 CFR 3500.14(g)(2), that:

> The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. *If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided.* These facts may be used as evidence of a violation of section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation. The value of a referral (i.e., the value of any additional business obtained thereby) is not to be taken into account in determining whether the payment exceeds the reasonable value of such goods, facilities or services. * * * (emphasis supplied).

In addition, Regulation X clarifies that "[w]hen a person in a position to refer settlement service business * * * receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person." (24 CFR 3500.14(g)(3).)

Since 1992, HUD has provided various interpretations and other issuances under these rules stating the Department's position that the legality of a payment to a mortgage broker is not premised on the name of the particular fee. Rather, HUD has consistently advised that the issue under RESPA is whether the compensation to a mortgage broker in covered transactions is reasonably related to the value of the goods or facilities actually furnished or services actually performed. If the compensation, or a portion thereof, is not reasonably related to the goods or facilities actually furnished or the services actually performed, there is a compensated referral or an unearned fee in violation of Section 8(a) or 8(b) of RESPA, whether the compensation is a direct or indirect payment or a combination thereof.

F. Recent HUD Rulemaking Efforts

The Department received comments on the 1992 rule's requirement that mortgage brokers disclose indirect payments from lenders on the GFE and the settlement statement. In response, the Department reviewed whether the disclosure of indirect or back-funded fees is necessary or in the borrower's interest and whether additional rulemaking was needed to clarify the legality of fees to mortgage brokers. Brokers had alleged that these disclosures were confusing to consumers and disadvantaged brokers as compared to other originators who were within the secondary market exemption and were not required to disclose their compensation for the subsequent sale of the loan. Consumer representatives said that consumers needed to understand the existence of indirect fees and whether brokers represented consumers in shopping for

loans. On September 13, 1995, the Department issued a proposed rule (60 FR 47650) and in December 1995 through May 1996, embarked on a negotiated rulemaking on these subjects.

Although the negotiated rulemaking did not result in consensus, on October 16, 1997, HUD published a proposed rule (62 FR 53912) that was shaped by views from both industry and consumer representatives provided during the negotiated rulemaking (as well as by comments received from the September 13, 1995, proposed rule (60 FR 47650)). The 1997 proposed rule proposed a qualified "safe harbor" for payments to mortgage brokers under Section 8. Under the proposal, if a broker enters into a contract with consumers explaining the broker's functions (whether or not it represented the consumer) and the total compensation the broker would receive in the transaction, before the consumer applied for a loan, HUD would presume the broker fees, both direct and indirect, to be legal. The 1997 proposal also provided, however, that this qualified safe harbor would only be available to those payments that did not exceed a test, to be established in the rulemaking, to preclude unreasonable fees. This proposal was intended, among other things, to establish that yield spread premiums paid to brokers meeting the rule's requirements were presumed legal when brokers provided consumers with prescribed information concerning the functions and compensation of mortgage brokers. The Department has received over 9,000 comments in response to this proposed rule.

G. Litigation

During the last several years, more than 150 lawsuits have been brought seeking class action certification based in whole or in part on the theory that the making of indirect payments from lenders to mortgage brokers violates Section 8 of RESPA. In various cases, plaintiffs have argued that yield spread premiums or other denominated indirect payments to

brokers, regardless of their amount, constitute prohibited referral fees under Section 8(a). These plaintiffs generally argue that yield spread premiums are payments based upon the broker's ability to deliver a loan that is above the par rate. Some lawsuits have alleged that such yield spread premiums or other indirect payments are a split of fees between the lender and the broker, or are simply unearned fees and, therefore, also violate Section 8(b) of RESPA. Other challenges rely, in part, on the alleged unreasonableness of brokers' fees. These complaints assert that under the RESPA regulations, payments must bear a reasonable relationship to the market value of the good or the service provided and that payments in excess of such amounts must be regarded as forbidden referral fees.

Many of the lawsuits involve allegations that consumers were not informed by mortgage brokers concerning the mortgage brokers' role and compensation. A common element in many allegations is that borrowers were not informed about the existence or the amount of the yield spread premiums paid to the mortgage broker, and the relationship of the yield spread premium to the direct fees that the borrower paid. The facts in these cases suggest generally that even where there were proper disclosures on the GFE and the settlement statement, borrowers allege that they were unaware of, or did not understand, that a yield spread premium was tied to the interest rate they agreed to pay, and that they could have reduced this charge or their direct payment to the broker either by further negotiation or by engaging in additional shopping among mortgage loan providers.

Courts have been split in their decisions on these cases. Some of the decisions have concluded that yield spread premiums may be prohibited referral fees or duplicative fees in contravention of Section 8 of RESPA under the specific facts of the case. Some have held that the permissibility of

yield spread premiums must be based on an analysis of whether the premiums constitute a reasonable payment, either alone or in combination with any direct fee paid by the borrower, for either the goods, services or facilities actually furnished. Because some courts have found that this necessitates an individual analysis of the facts of each transaction, some courts have denied plaintiffs' requests for class action certification. Some courts have certified a class without reaching a conclusion on the RESPA issues. Others have held that yield spread premiums constitute valid consideration to the mortgage broker in exchange for the origination of the loan and the sale of the loan to the lender. These courts have found that the payment of yield spread premiums is one method among many of compensating the broker for the origination services rendered.

H. Reform

In July 1998, the Department and the Federal Reserve Board delivered a report to Congress recommending significant improvements to streamline and simplify current RESPA and Truth In Lending Act requirements. The Report proposed that along with a tighter and more enforceable scheme for providing consumers with estimated costs for settlements, an exemption from Section 8's prohibitions should be established for those entities that offer a package of settlement services and a mortgage loan at a guaranteed price, rate and points for the package early in the consumer's process of shopping for a loan. Such an approach, which also includes other additional consumer protection recommendations, would largely resolve these issues for any mortgage broker who chooses to abide by the requirements of this exemption. The Report's consumer protection recommendations included, among other items, that Congress consider establishment of an unfair and deceptive acts and practices remedy under the "packaging" proposal set forth in the Report, settlement costs would be controlled more effectively

by market forces. Consumers would be better able to comparison-shop, thereby encouraging creditors and others to operate efficiently and pass along discounts and lower prices. In addition, the Report's recommendations would greatly simplify compliance for the industry and clarify legal uncertainties that create liability risks.

I. This Policy Statement

This policy statement provides HUD's views of the legality of fees to mortgage brokers from lenders under existing law. In accordance with the Conference Report, in developing this policy statement, HUD met with representatives of government agencies, as well as a broad range of consumer and industry groups, including the Office of Thrift Supervision, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Federal Reserve Board, the National Association of Mortgage Brokers, the Mortgage Bankers Association of America, the American Bankers Association, the Consumer Mortgage Coalition, America's Community Bankers, the Consumer Bankers Association, the Independent Bankers Association of America, AARP, the National Consumer Law Center, Consumers Union, and the National Association of Consumer Advocates.

II. RESPA Policy Statement 1999-1

A. Introduction

The Department hereby states its position on the legality of payments by lenders to mortgage brokers under the Real Estate Settlement Procedures Act (12 U.S.C. 2601 *et seq.*) (RESPA) and its implementing regulations at 24 CFR part 3500 (Regulation X). This Statement of Policy is issued pursuant to Section 19(a) of RESPA (12 U.S.C. 2617(a)) and 24 CFR 3500.4(a)(1)(ii). HUD is cognizant of the Conferees' statement in the Conference Report on the FY 1999 HUD Appropriations Act that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually

furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. Sec. 2607) in its enactment of RESPA." (H. Rep. 105–769, at 260.) The Department is also cognizant of the congressional intent in enacting RESPA of protecting consumers from unnecessarily high settlement charges caused by abusive practices. (12 U.S.C. 2601.)

In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (i.e., yield spread premiums or any other class of named payments), to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The fees in cases or classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.

In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.

In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a

combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets.

B. Scope

In light of 24 CFR § 3500.5(b)(7), which exempts from RESPA coverage *bona fide* transfers of loan obligations in the secondary market, this policy statement encompasses only transactions where mortgage brokers are not the real source of funds (*i.e.*, tablefunded transactions or transactions involving "intermediary" brokers). In table-funded transactions, the mortgage broker originates, processes and closes the loan in the broker's own name and, at or about the time of settlement, there is a simultaneous advance of the loan funds by the lender and an assignment of the loan to that lender. (See 24 CFR 3500.2 (Definition of "table funding").) Likewise, in transactions where mortgage brokers are intermediaries, the broker provides loan origination services and the loan funds are provided by the lender; the loan, however, is closed in the lender's name.

C. Payments Must Be for Goods, Facilities or Services

In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker. In making the determination of whether compensable services are performed, HUD's letter to the Independent Bankers Association of America, dated February 14, 1995 (IBAA letter) may

be useful. In that letter, HUD identified the following services normally performed in the origination of a loan:

(a) Taking information from the borrower and filling out the application; [4]

(b) Analyzing the prospective borrower's income and debt and prequalifying the prospective borrower to determine the maximum mortgage that the prospective borrower can afford;

(c) Educating the prospective borrower in the home buying and financing process, advising the borrower about the different types of loan products available, and demonstrating how closing costs and monthly payments could vary under each product;

(d) Collecting financial information (tax returns, bank statements) and other related documents that are part of the application process;

(e) Initiating/ordering VOEs (verifications of employment) and VODs (verifications of deposit);

(f) Initiating/ordering requests for mortgage and other loan verifications;

(g) Initiating/ordering appraisals;

(h) Initiating/ordering inspections or engineering reports;

(i) Providing disclosures (truth in lending, good faith estimate, others) to the borrower;

(j) Assisting the borrower in understanding and clearing credit problems;

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[4] In a subsequent informal interpretation, dated June 20, 1995, HUD stated that the filling out of a mortgage loan application could be substituted by a comparable activity, such as the filling out of a borrower's worksheet.

(k) Maintaining regular contact with the borrower, realtors, lender, between application and closing to appraise them of the status of the application and gather any additional information as needed;

(l) Ordering legal documents;

(m) Determining whether the property was located in a flood zone or ordering such service; and

(n) Participating in the loan closing.

While this list does not exhaust all possible settlement services, and while the advent of computer technology has, in some cases, changed how a broker's settlement services are performed, HUD believes that the letter still represents a generally accurate description of the mortgage origination process. For other services to be acknowledged as com pensable under RESPA, they should be identifiable and meaningful services akin to those identified in the IBAA letter including, for example, the operation of a computer loan origination system (CLO) or an automated underwriting system (AUS).

The IBAA letter provided guidance on whether HUD would take an enforcement action under RESPA. In the context of the letter's particular facts and subject to the reasonableness test which is discussed below, HUD articulated that it generally would be satisfied that sufficient origination work was performed to justify compensation if it found that:

- The lender's agent or contractor took the application information (under item (a)); and
- The lender's agent or contractor performed at least five additional items on the list above.

In the letter and in the context of its facts, HUD also pointed out that it is concerned that a fee for steering a customer to a particular lender could be disguised as compensation for "counseling-type" activities. Therefore, the

letter states that if an agent or contractor is relying on taking the application and performing only "counseling type" services—(b), (c), (d), (j), and (k) on the list above—to justify its fee, HUD would also look to see that meaningful counseling—not steering—is provided. In analyzing transactions addressed in the IBAA letter, HUD said it would be satisfied that no steering occurred if it found that:

- Counseling gave the borrower the opportunity to consider products from at least three different lenders;
- The entity performing the counseling would receive the same compensation regardless of which lender's products were ultimately selected; *and*
- Any payment made for the "counseling-type" services is reasonably related to the services performed and not based on the amount of loan business referred to a particular lender.

In examining services provided by mortgage brokers and payments to mortgage brokers, HUD will look at the types of origination services listed in the IBAA letter to help determine whether compensable services are performed.[5] However, the IBAA letter responded to a program where a relatively small fee was to be provided for limited services by lenders that were brokering loans.[6]

Accordingly, the formulation in the IBAA letter of the number of origination services which may be required to be performed for compensation is not dispositive in analyzing

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[5] In the June 20, 1995 letter, the Department clarified that the counseling test in the IBAA letter would not apply if an entity performed only noncounseling services (a, e, f, g, h, i, l, m, n) or a mix of counseling and non-counseling services (but did not rely only on the five counseling services (b, c, d, j, and k)).

[6] In the particular program reviewed by HUD in the IBAA letter, the average total compensation for performing six of the origination services listed above was below $200.

more costly mortgage broker transactions where more comprehensive services are provided. The determinative test under RESPA is the relationship of the services, goods or facilities furnished to the total compensation received by the broker (discussed below). In addition to services, mortgage brokers may furnish goods or facilities to the lender. For example, appraisals, credit reports, and other documents required for a complete loan file may be regarded as goods, and a reasonable portion of the broker's retail or "store-front" operation may generally be regarded as a facility for which a lender may compensate a broker. However, while a broker may be compensated for goods or facilities actually furnished or services actually performed, the loan itself, which is arranged by the mortgage broker, cannot be regarded as a "good" that the broker may sell to the lender and that the lender may pay for based upon the loan's yield's relation to market value, reasonable or otherwise. In other words, in the context of a non-secondary market mortgage broker transaction, under HUD's rules, it is not proper to argue that a loan is a "good," in the sense of an instrument bearing a particular yield, thus justifying any yield spread premium to the mortgage broker, however great, on the grounds that such yield spread premium is the "market value" of the good.

D. Compensation Must Be Reasonably Related to Value of Goods, Facilities or Services

The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker, as described in the IBAA letter, does not by itself make a payment by a lender to a mortgage broker legal. The next inquiry is whether the payment is reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. Although RESPA is not a rate-making statute, HUD is authorized to ensure that payments from lenders to mortgage brokers are reasonably related to the value of the goods or

facilities actually furnished or services actually performed, and are not compensation for the referrals of business, splits of fees or unearned fees.

In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with that amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets.[7] If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. (See 24 CFR 3500.14(g)(2).) Moreover, HUD also believes that the market price used to determine whether a particular payment meets the reasonableness test may not include a referral fee or unearned fee, because such fees are prohibited by RESPA. Congress was clear that for payments to be legal under Section 8, they must bear a reasonable relationship to the value received by the person or company making the payment. (S. Rep. 93–866, at 6551.)

The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible to identify or allocate which

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[7] HUD recognizes that settlement costs may vary in different markets. The cost of a specific service in Omaha, Nebraska, for example, may bear little resemblance to the cost of a similar service in Los Angeles, California.

facilities, goods or services are performed or provided for the lender, for the consumer, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible (e.g., an appraisal is necessary to assure that the lender has adequate security, as well as to advise the borrower of the value of the property and to complete the borrower's loan).

The consumer is ultimately purchasing the total loan and is ultimately paying for all the services needed to create the loan. All compensation to the broker either is paid by the borrower in the form of fees or points, directly or by addition to principal, or is derived from the interest rate of the loan paid by the borrower. Accordingly, in analyzing whether lender payments to mortgage brokers comport with the requirements of Section 8 of RESPA, HUD believes that the totality of the compensation to the mortgage broker for the loan must be examined. For example, if the lender pays the mortgage broker $600 and the borrower pays the mortgage broker $500, the total compensation of $1,100 would be examined to determine whether it is reasonably related to the goods or facilities actually furnished or services actually performed by the broker.

Therefore, in applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether total compensation is legal under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. All payments, including payments based upon a percentage of the loan amount, are subject to the reasonableness test defined above. In applying this test, the Department considers that higher interest rates alone cannot justify higher total fees to

mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. In so-called "no-cost" loans, borrowers accept a higher interest rate in order to reduce direct fees, and the absence of direct payments to the mortgage broker is made up by higher indirect fees (e.g., yield spread premiums). Higher indirect fees in such arrangements are legal if, and only if, the total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In so-called "no-cost" loans, borrowers accept a higher interest rate in order to reduce direct fees, and the absence of direct payments to the mortgage broker is made up by higher indirect fees (e.g., yield spread premiums). Higher indirect fees in such arrangements are legal if, and only if, the total compensation is reasonably related to the goods or facilities actually furnished or services actually performed.

In determining whether the compensation paid to a mortgage broker is reasonably related to the goods or facilities actually furnished or services actually performed, HUD will consider all compensation, including any volume based compensation. In this analysis, there may be no payments merely for referrals of business under Section 8 of RESPA. (See 24 CFR 3500.14.)[8]

Under HUD's rules, when a person in a position to refer settlement service business receives a payment for providing additional settlement services as part of the transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by the person. (24

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[8] The Department generally has held that when the payment is based on the volume or value of business transacted, it is evidence of an agreement for the referral of business (unless, for example, it is shown that payments are for legitimate business reasons unrelated to the value of the referrals). (*See* 24 CFR 3500.14(e).)

CFR 3500.14(g)(3).) While mortgage brokers may receive part of their compensation from a lender, where the lender payment duplicates direct compensation paid by the borrower for goods or facilities actually furnished or services actually performed, Section 8 is violated. In light of the fact that the borrower and the lender may both contribute to some items, HUD believes that it is best to evaluate seemingly duplicative fees by analyzing total compensation under the reasonableness test described above.

E. Information Provided to Borrower

Under current RESPA rules mortgage brokers are required to disclose estimated direct and indirect fees on the Good Faith Estimate (GFE) no later than 3 days after loan application. (See 24 CFR 3500.7(a) and (b).) Such disclosure must also be provided to consumers, as a final exact figure, at closing on the settlement statement. (24 CFR 3500.8; 24 CFR part 3500, Appendix A.) On the GFE and the settlement statement, lender payments to mortgage brokers must be shown as "Paid Outside of Closing" (P.O.C.), and are not computed in arriving at totals. (24 CFR 3500.7(a)(2).) The requirement that all fees be disclosed on the GFE is intended to assure that consumers are shown the full amount of compensation to brokers and others early in the transaction.

The Department has always indicated that any fees charged in settlement transactions should be clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like "YSP to DBG, POC", for instance, have been noted.[9] Also, the Department

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[9] This is an example only. HUD recognizes that current practices may leave borrowers confused. However, the use of any particular terms, including abbreviations, may not, by itself, violate RESPA. Nevertheless, going forward, HUD recommends that the disclosures on the GFE and the settlement statement be as described in the text. HUD recognizes that system changes may require time for lenders and brokers to implement.

has seen examples on the GFE and/or the settlement statement where the identity and/or purpose of the fees are not clearly disclosed.

The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee (in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. For example, a fee would be appropriately disclosed as "Mortgage broker fee from lender to XYZ Corporation (P.O.C.)." In the interest of clarity, other fees or payments from the borrower to the mortgage broker should identify that they are mortgage broker fees from the borrower.[10]

There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. Mortgage brokers and lenders can improve their ability to demonstrate the reasonableness of their fees if the broker discloses the nature of the broker's services and the various methods of compensation at the time the consumer first discusses the possibility of a loan with the broker.

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[10] HUD recognizes that current software may not currently accommodate these additional disclosures. Both industry and consumers would be better served if these additional disclosures were included in future forms.

The legislative history makes clear that RESPA was not intended to be a rate-setting statute and that Congress instead favored a market-based approach. (S. Rep. No. 93-866 at 6546 (1974).) In making the determination of whether a payment is *bona fide* compensation for goods or facilities actually furnished or services actually performed, HUD has, in the past, indicated that it would examine whether the price paid for the goods, facilities or services is truly a market price; that is, if in an arm's length transaction a purchaser would buy the services at or near the amount charged. If the fee the consumer pays is disclosed and agreed to, along with its relationship to the interest rate and points for the loan and any lender-paid fees to the broker, a market price for the services, goods or facilities could be attained. HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and determine what price they are willing to pay for the loan based on disclosures which provide clear and understandable information.

The Department reiterates its longstanding view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law, pre-application disclosure to the consumer is not required, HUD believes that fuller information provided at the earliest possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding.

HUD commends the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting that their members furnish consumers with a form describing the function of mortgage brokers and stating that a mortgage broker may receive a fee in the transaction from a lender.

Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure

would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's agent to shop for a loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up that compensation. If indirect fees are paid, the consumer would be made aware of the amount of these fees and their relationship to direct fees and an increased interest rate. If the consumer may reduce the interest rate through increased fees or points, this option also would be explained. HUD recognizes that in many cases, the industry has not been using this approach because it has not been required. Moreover, new methods may require time to implement. HUD encourages these efforts going forward and believes that if these desirable disclosure practices were adhered to by all industry participants, the need for more prescriptive regulatory or legislative actions concerning this specific problem could be tempered or even made unnecessary.

While the Department is issuing this statement of policy to comply with a Congressional directive that HUD clarify its position on the legality of lender payments to mortgage brokers, HUD agrees with segments of the mortgage lending and settlement service industries and consumer representatives that legislation to improve RESPA is needed. HUD believes that broad legislative reform along the lines specified in the HUD/Federal Reserve Board Report remains the most effective way to resolve the difficulties and legal uncertainties under RESPA and TILA for industry and consumers alike. Statutory changes like those recommended in the Report would, if adopted, provide the most balanced approach to resolving these contentious issues by providing consumers with better and firmer information about the costs associated

with home-secured credit transactions and providing creditors and mortgage brokers with clearer rules.

III. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) reviewed this Statement of Policy under Executive Order 12866, *Regulatory Planning and Review*. OMB determined that this Statement of Policy is a "significant regulatory action," as defined in section 3(f) of the Order (although not economically significant, as provided in section 3(f)(1) of the Order). Any changes made to the Statement of Policy subsequent to its submission to OMB are identified in the docket file, which is available for public inspection in the office of the Department's Rules Docket Clerk, Room 10276, 451 Seventh Street, SW, Washington, DC 20410-0500.

Dated: February 22, 1999.

William C. Apgar,
Assistant Secretary for Housing-Federal Housing Commissioner.

[FR Doc. 99-4921 Filed 2–26–99; 8:45 am]

APPENDIX B

DEPARTMENT OF HOUSING AND
URBAN DEVELOPMENT
24 CFR Part 3500

[Docket No. FR–4714–N–01]

RIN 2502–AH74

Real Estate Settlement Procedures Act Statement of Policy 2001-1:

Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b)

AGENCY: Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

ACTION: Statement of Policy 2001–1.

SUMMARY: This Statement of Policy is being issued to eliminate any ambiguity concerning the Department's position with respect to those lender payments to mortgage brokers characterized as yield spread premiums and to overcharges by settlement service providers as a result of questions raised by two recent court decisions, *Culpepper* v. *Irwin Mortgage Corp.* and *Echevarria* v. *Chicago Title and Trust Co.*, respectively. In issuing this Statement of Policy, the Department clarifies its interpretation of Section 8 of the Real Estate Settlement Procedures Act (RESPA) in Statement of Policy 1999–1 Regarding Lender Payments to Mortgage Brokers (the 1999 Statement of Policy), and reiterates its long-standing interpretation of Section 8(b)'s prohibitions. *Culpepper* v. *Irwin Mortgage Corp.* involved the payment of yield spread premiums from lenders to mortgage brokers. *Echevarria* v. *Chicago Title and Trust Co.* involved the

applicability of Section 8(b) to a settlement service provider that overcharged a borrower for the service of another settlement service provider, and then retained the amount of the overcharge.

Today's Statement of Policy reiterates the Department's position that yield spread premiums are not per se legal or illegal, and clarifies the test for the legality of such payments set forth in HUD's 1999 Statement of Policy. As stated there, HUD's position that lender payments to mortgage brokers are not illegal per se does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The legality of yield spread premiums turns on the application of HUD's test in the 1999 Statement of Policy as clarified today.

The Department also reiterates its long-standing position that it may violate Section 8(b) and HUD's implementing regulations: (1) For two or more persons to split a fee for settlement services, any portion of which is unearned; or (2) for one settlement service provider to mark-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) for one settlement service provider to charge the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

This Statement of Policy also reiterates the importance of disclosure so that borrowers can choose the best loan for themselves, and it describes disclosures HUD considers best practices. The Secretary is also announcing that he intends to make full use of his regulatory authority to establish clear requirements for disclosure of mortgage broker fees and to improve the settlement process for lenders, mortgage brokers, and consumers.

EFFECTIVE DATE: October 18, 2001.

FOR FURTHER INFORMATION CONTACT: Ivy M. Jackson, Acting Director, RESPA/ILS Division, Room 9156, U.S. Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410; telephone (202) 708-0502, or (for legal questions) Kenneth A. Markison, Assistant General Counsel for GSE/RESPA, Room 9262, Department of Housing and Urban Development, Washington, DC 20410; telephone (202) 708-3137 (these are not toll-free numbers). Persons who have difficulty hearing or speaking may access this number via TTY by calling the toll-free Federal Information Relay Service at (800) 877–8339.

SUPPLEMENTARY INFORMATION:

General Background

The Department is issuing this Statement of Policy in accordance with 5 U.S.C. 552 as a formal pronouncement of its interpretation of relevant statutory and regulatory provisions. Section 19(a) (12 U.S.C. 2617(a)) of the Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601-2617) (RESPA) specifically authorizes the Secretary "to prescribe such rules and regulations [and] to make such interpretations * * * as may be necessary to achieve the purposes of [RESPA]."

Section 8(a) of RESPA prohibits any person from giving and any person from accepting "any fee, kickback, or thing of value pursuant to an agreement or understanding, oral or otherwise" that real estate settlement service business shall be referred to any person. See 12 U.S.C. 2607(a). Section 8(b) prohibits anyone from giving or accepting "any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service * * * other than for services actually performed." 12 U.S.C. 2607(b). Section 8(c) of RESPA provides, "Nothing in [Section 8] shall be construed as prohibiting * * * (2) the payment to any person

of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed * * *" 12 U.S.C. 2607(c)(2). RESPA also requires the disclosure of settlement costs to consumers at the time of or soon after a borrower applies for a loan and again at the time of real estate settlement. 12 U.S.C. 2603–4. RESPA's requirements apply to transactions involving a "federally related mortgage loan" as that term is defined at 12 U.S.C. 2602(1).

I. Lender Payments to Mortgage Brokers

The Conference Report on the Department's 1999 Appropriations Act directed HUD to address the issue of lender payments to mortgage brokers under RESPA. The Conference Report stated that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) (12 U.S.C. sec. 2607) in its enactment of RESPA." H. Rep. 105–769, at 260. As also directed by Congress, HUD worked with industry groups, federal agencies, consumer groups and other interested parties in collectively producing the 1999 Statement of Policy issued on March 1, 1999. 64 FR 10080. Interested members of the public are urged to consult the 1999 Statement of Policy for a more detailed discussion of the background on lender payments to brokers addressed in today's Statement.

HUD's 1999 Statement of Policy established a two-part test for determining the legality of lender payments to mortgage brokers for table funded transactions and intermediary transactions under RESPA: (1) Whether goods or facilities were actually furnished or services were actually performed for the compensation paid and; (2) whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed. In applying this test, HUD believes that total compensation should be scrutinized to assure that it is

reasonably related to the goods, facilities, or services furnished or performed to determine whether it is legal under RESPA. In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed for the total compensation paid to the mortgage broker. Where a lender payment to a mortgage broker comprises a portion of total broker compensation, the amount of the payment is not, under the HUD test, scrutinized separately and apart from total broker compensation.

Since HUD issued its 1999 Statement of Policy, most courts have held that yield spread premiums from lenders to mortgage brokers are legal provided that such payments meet the test for legality articulated in the 1999 Statement of Policy and otherwise comport with RESPA. However, in a recent decision, *Culpepper* v. *Irwin Mortgage Corp.*, 253 F.3d 1324 (11th Cir. 2001), the Court of Appeals for the Eleventh Circuit upheld certification of a class in a case alleging that yield spread premiums violated Section 8 of RESPA where the defendant lender, pursuant to a prior understanding with mortgage brokers, paid yield spread premiums to the brokers based solely on the brokers' delivery of above par interest rate loans. The court concluded that a jury could find that yield spread premiums were illegal kickbacks or referral fees under RESPA where the lender's payments were based exclusively on interest rate differentials reflected on rate sheets, and the lender had no knowledge of what services, if any, the broker performed. The court described HUD's 1999 Statement of Policy as "ambiguous." *Id.* at 1327. Accordingly, and because courts have now rendered conflicting decisions, HUD has an obligation to clarify its position and issues this Statement today to provide such clarification and certainty to lenders, brokers, and consumers.

Because this clarification focuses on the legality of lender payments to mortgage brokers in transactions subject to RESPA, the coverage of this statement is restricted to payments to mortgage brokers in table funded and intermediary broker transactions. Lender payments to mortgage brokers where mortgage brokers initially fund the loan and then sell the loan after settlement are outside the coverage of this statement as exempt from RESPA under the secondary market exception.

II. Disclosure

Besides establishing the two-part test for determining the legality of yield spread premiums, the 1999 Statement of Policy discussed the importance of disclosure in permitting borrowers to choose the best loan for themselves. The mortgage transaction is complicated, and most people engage in such transactions relatively infrequently, compared to the other purchases they make. In some instances, borrowers have paid very large origination costs, either up front fees, yield spread premiums, or both, which they might have been able to avoid with timely disclosure. Timely disclosure would permit them to shop for preferable origination costs and mortgage terms and to agree to those costs and terms that meet their needs. The Department therefore is issuing a clarification of the importance of disclosure, with a description of disclosures that it considers to be best practices.

In this Statement of Policy, the Secretary is announcing that he intends to make full use of his regulatory authority as expeditiously as possible to provide clear requirements and guidance prospectively regarding disclosure of mortgage broker fees and, more broadly, to improve the mortgage settlement process so that homebuyers and homeowners are better served. Pending the promulgation of such a rule, the Secretary asks the industry to adopt new disclosure requirements to promote competition and to better serve consumers.

III. Unearned Fees

The 1999 Statement of Policy also touched upon another area of recurring questions under Section 8 of RESPA: the legality of payments that are in excess of the reasonable value of the goods or facilities provided or services performed. See 64 FR 10082-3.

Since RESPA was enacted, HUD has consistently interpreted Section 8(b) and HUD's RESPA regulations to prohibit settlement service providers from charging unearned fees, as occurred in *Echevarria* v. *Chicago Title & Trust Co.*, 256 F.3d 623 (7th Cir. 2001). Such an interpretation is consistent with Congress's finding, when enacting RESPA, that consumers need protection from unnecessarily high settlement costs. Through this Statement of Policy, HUD makes clear that Section 8(b) prohibits any person from giving or accepting any fees other than payments for goods and facilities provided or services actually performed. Payments that are unearned fees occur in, but are not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one settlement service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

In a July 5, 2001 decision, the Court of Appeals for the Seventh Circuit concluded that unearned fees must be passed from one settlement provider to another in order for such fees to violate Section 8(b). Accordingly, the court held that a settlement service provider did not violate Section 8(b) when, in billing a borrower, it added an overcharge to another

provider's fees and retained the additional charge without providing any additional goods, facilities or services. *Echevarria* v. *Chicago Title & Trust Co.* Other courts have held that two or more parties must split or share a fee in order for a violation of Section 8(b) to occur. Still other courts have stated, however, that a single provider can violate Section 8(b). Because the courts are now divided, HUD is issuing this Statement of Policy to reiterate its interpretation of Section 8(b).

The Court of Appeals for the Seventh Circuit rendered its conclusion in *Echevarria* "absent a formal commitment by HUD to an opposing position. * * *" *Id.* at 630. In issuing this Statement of Policy pursuant to Section 19(a), HUD reiterates its position on unearned fees under Section 8(b) of RESPA, which HUD regards as long standing.

IV. Statement of Policy 2001-1

To give guidance to interested members of the real estate settlement industry and the general public on the application of RESPA and its implementing regulations, the Secretary hereby issues the following Statement of Policy. The interpretations embodied in this Statement of Policy are issued pursuant to Section 19(a) of RESPA. 12 U.S.C. 2617(a).

Part A. Mortgage Broker Fees

Yield Spread Premiums

One of the primary barriers to homeownership and homeowners' ability to refinance and lower their housing costs is the up front cash needed to obtain a mortgage. The closing costs and origination fees associated with a mortgage loan are a significant component of these up front cash requirements. Borrowers may choose to pay these fees out of pocket, or to pay the origination fees, and possibly all the closing fees, by financing them; *i.e.*, adding the amount of

such fees to the principal balance of their mortgage loan. The latter approach, however, is not available to those whose loan-to-value ratio has already reached the maximum permitted by the lender. For those without the available cash, who are at the maximum loan-to-value ratio, or who simply choose to do so, there is a third option. This third option is a yield spread premium.

Yield spread premiums permit homebuyers to pay some or all of the up front settlement costs over the life of the mortgage through a higher interest rate. Because the mortgage carries a higher interest rate, the lender is able to sell it to an investor at a higher price. In turn, the lender pays the broker an amount reflective of this price difference. The payment allows the broker to recoup the up front costs incurred on the borrower's behalf in originating the loan. Payments from lenders to brokers based on the rates of borrowers' loans are characterized as "indirect" fees and are referred to as yield spread premiums.[1]

A yield spread premium is calculated based upon the difference between the interest rate at which the broker originates the loan and the par, or market, rate offered by a lender. The Department believes, and industry and consumers agree, that a yield spread premium can be a useful means to pay some or all of a borrower's settlement costs. In these cases, lender payments reduce the up front cash requirements to borrowers. In some cases, borrowers are able to obtain loans without paying any up front cash for the services required in connection with the origination of the loan. Instead, the fees for these services are financed through a higher interest rate on the loan. The yield spread premium thus can be a legitimate tool to assist the borrower. The availability of this option fosters homeownership.

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[1] Indirect fees from lenders are also known as "back funded payments," "overages," or "servicing release premiums."

HUD has recognized the utility of yield spread premiums in regulations issued prior to the 1999 Statement of Policy. In a final rule concerning "Deregulation of Mortgagor Income Requirements," HUD indicated that up front costs could be lowered by yield spread premiums.54 FR 38646 (September 20, 1989).

In a 1992 rule concerning RESPA, HUD specifically listed yield spread premiums as an example of fees that must be disclosed. The example was codified as Illustrations of Requirements of RESPA, Fact Situations 5 and 13 in Appendix B to 24 CFR part 3500. (See also Instructions at Appendix A to 24 CFR part 3500 for Completing HUD–1 and HUD–1A Settlement Statements.) HUD did not by these examples mean that yield spread premiums were *per se* legal, but HUD also did not mean that yield spread premiums were *per se* illegal.

HUD also recognizes, however, that in some cases less scrupulous brokers and lenders take advantage of the complexity of the settlement transaction and use yield spread premiums as a way to enhance the profitability of mortgage transactions without offering the borrower lower up front fees. In these cases, yield spread premiums serve to increase the borrower's interest rate and the broker's overall compensation, without lowering up front cash requirements for the borrower. As set forth in this Statement of Policy, such uses of yield spread premiums may result in total compensation in excess of what is reasonably related to the total value of the origination services provided by the broker, and fail to comply with the second part of HUD's two-part test as enunciated in the 1999 Statement of Policy, and with Section 8.

The 1999 Statement of Policy's Test for Legality

The Department restates its position that yield spread premiums are not per se illegal. HUD also reiterates that this statement "does not imply * * * that yield spread premiums

are legal in individual cases or classes of transactions." 64 FR 10084. The legality of any yield spread premium can only be evaluated in the context of the test HUD established and the specific factual circumstances applicable to each transaction in which a yield spread premium is used.

The 1999 Statement of Policy established a two-part test for determining whether lender payments to mortgage brokers are legal under RESPA. In applying Section 8 and HUD's regulations, the 1999 Statement of Policy stated:

> In transactions where lenders make payments to mortgage brokers, HUD does not consider such payments (*i.e.*, yield spread premiums or any other class of named payments) to be illegal *per se*. HUD does not view the name of the payment as the appropriate issue under RESPA. HUD's position that lender payments to mortgage brokers are not illegal *per se* does not imply, however, that yield spread premiums are legal in individual cases or classes of transactions. The fees in cases and classes of transactions are illegal if they violate the prohibitions of Section 8 of RESPA.
>
> In determining whether a payment from a lender to a mortgage broker is permissible under Section 8 of RESPA, the first question is whether goods or facilities were actually furnished or services were actually performed for the compensation paid. The fact that goods or facilities have been actually furnished or that services have been actually performed by the mortgage broker does not by itself make the payment legal. The second question is whether the payments are reasonably related to the value of the goods or facilities that were actually furnished or services that were actually performed.
>
> In applying this test, HUD believes that total compensation should be scrutinized to assure that it is reasonably related to goods, facilities, or services furnished or performed to determine whether it is legal

under RESPA. Total compensation to a broker includes direct origination and other fees paid by the borrower, indirect fees, including those that are derived from the interest rate paid by the borrower, or a combination of some or all. The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. HUD believes that total compensation should be carefully considered in relation to price structures and practices in similar transactions and in similar markets. 64 FR 10084.

Culpepper

The need for further clarification of HUD's position, as set forth in the 1999 Statement of Policy, on the treatment of lender payments to mortgage brokers under Section 8 of RESPA (12 U.S.C. 2607), is evident from the recent decision of the Court of Appeals for the Eleventh Circuit in *Culpepper.*

In upholding class certification in *Culpepper,* the court only applied the first part of the HUD test, and then further narrowed its examination of whether the lender's yield spread payments were "for services" by focusing exclusively on the presumed intent of the lender in making the payments. The crux of the court's decision is that Section 8 liability for the payment of unlawful referral fees could be established under the first part of the HUD test alone, based on the facts that the lender's payments to mortgage brokers were calculated solely on the difference between the par interest rate and the higher rate at which the mortgage brokers delivered loans, and that the lender had no knowledge of what services, if any, the brokers had performed.

HUD was not a party to the case and disagrees with the judicial interpretation regarding Section 8 of RESPA and the 1999 Statement of Policy.

Clarification of the HUD Test

It is HUD's position that where compensable services are performed, the 1999 Statement of Policy requires application of both parts of the HUD test before a determination can be made regarding the legality of a lender payment to a mortgage broker.

1. *The First Part of the HUD Test:* Under the first part of HUD's test, the total compensation to a mortgage broker, of which a yield spread premium may be a component or the entire amount, must be for goods or facilities provided or services performed. HUD's position is that in order to discern whether a yield spread premium was for goods, facilities or services under the first part of the HUD test, it is necessary to look at each transaction individually, including examining all of the goods or facilities provided or services performed by the broker in the transaction, whether the goods, facilities or services are paid for by the borrower, the lender, or partly by both.

It is HUD's position that neither Section 8(a) of RESPA nor the 1999 Statement of Policy supports the conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed. HUD considers the latter situation to be rare. The common industry practice is that lenders follow underwriting standards that demand a review of originations and that therefore lenders typically know that brokers have performed the services required to meet those standards.

Yield spread premiums are by definition derived from the interest rate. HUD believes that a rate sheet is merely a mechanism for displaying the yield spread premium, and does not indicate whether a particular yield spread premium is a payment for goods and facilities actually furnished or services actually performed under the HUD test. Whether or not a yield spread premium is legal or illegal cannot be determined by the use of a rate sheet, but by how HUD's test applies to the transaction involved.

Section 8 prohibits the giving and accepting of fees, kickbacks, or things of value for the referral of settlement services and also unearned fees. It is therefore prudent for a lender to take action so as to ensure that brokers are performing compensable services and receiving only compensation that, in total, is reasonable for those services provided. As stated, however, in the 1999 Statement of Policy:

> The Department recognizes that some of the goods or facilities actually furnished or services actually performed by the broker in originating a loan are "for" the lender and other goods or facilities actually furnished or services actually performed are "for" the borrower. HUD does not believe that it is necessary or even feasible to identify or allocate which facilities, goods or services are performed or provided for the lender, for the borrower, or as a function of State or Federal law. All services, goods and facilities inure to the benefit of both the borrower and the lender in the sense that they make the loan transaction possible. * * * 64 FR 10086.

The 1999 Statement of Policy provided a list of compensable loan origination services originally developed by HUD in a response to an inquiry from the Independent Bankers Association of America (IBAA), which HUD considers relevant in evaluating mortgage broker services. In analyzing each transaction to determine if services are performed HUD believes the 1999 Statement of Policy should

be used as a guide. As stated there, the IBAA list is not exhaustive, and while technology is changing the process of performing settlement services, HUD believes that the list is still a generally accurate description of settlement services. Compensation for these services may be paid either by the borrower or by the lender, or partly by both. Compensable services for the first part of the test do not include referrals or no, nominal, or duplicative work.

2. *Reasonableness of Broker Fees:* The second part of HUD's test requires that total compensation to the mortgage broker be reasonably related to the total set of goods or facilities actually furnished or services performed.

The 1999 Statement of Policy said in part:

> The Department considers that higher interest rates alone cannot justify higher total fees to mortgage brokers. All fees will be scrutinized as part of total compensation to determine that total compensation is reasonably related to the goods or facilities actually furnished or services actually performed. 64 FR 10084.

Accordingly, the Department believes that the second part of the test is applied by determining whether a mortgage broker's total compensation is reasonable. Total compensation includes fees paid by a borrower and any yield spread premium paid by a lender, not simply the yield spread premium alone. Yield spread premiums serve to allow the borrower a lower up front cash payment in return for a higher interest rate, while allowing the broker to recoup the total costs of originating the loan. Total compensation to the broker must be reasonably related to the total value of goods or facilities provided or services performed by the broker. Simply delivering a loan with a higher interest rate is not a compensable service. The Department affirms the 1999 Statement of Policy's position on this matter for purposes of RESPA enforcement.

The 1999 Statement also said:

> In analyzing whether a particular payment or fee bears a reasonable relationship to the value of the goods or facilities actually furnished or services actually performed, HUD believes that payments must be commensurate with the amount normally charged for similar services, goods or facilities. This analysis requires careful consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets. If the payment or a portion thereof bears no reasonable relationship to the market value of the goods, facilities or services provided, the excess over the market rate may be used as evidence of a compensated referral or an unearned fee in violation of Section 8(a) or (b) of RESPA. 64 FR 10086.

The 1999 Statement of Policy also stated:

> The level of services mortgage brokers provide in particular transactions depends on the level of difficulty involved in qualifying applicants for particular loan programs. For example, applicants have differences in credit ratings, employment status, levels of debt, or experience that will translate into various degrees of effort required for processing a loan. Also, the mortgage broker may be required to perform various levels of services under different servicing or processing arrangements with wholesale lenders. 64 FR 10081.

In evaluating mortgage broker fees for enforcement purposes, HUD will consider these factors as relevant in assessing the reasonableness of mortgage broker compensation, as well as comparing total compensation for loans of similar size and similar characteristics within similar geographic markets.

Also, while the Department continues to believe that comparison to prices in similar markets is generally a key factor

in determining whether a mortgage broker's total compensation is reasonable, it is also true that in less competitive markets comparisons to the prices charged by other similarly situated providers may not, standing alone, provide a useful measure. As a general principle, HUD believes that in evaluating the reasonableness of broker compensation in less competitive markets, consideration of price structures from a wider range of providers may be warranted to reach a meaningful conclusion.

Part B. Providing Meaningful Information to Borrowers

In addition to addressing the legality of yield spread premiums in the 1999 Statement of Policy, HUD emphasized the importance of disclosing broker fees, including yield spread premiums

> There is no requirement under existing law that consumers be fully informed of the broker's services and compensation prior to the GFE. Nevertheless, HUD believes that the broker should provide the consumer with information about the broker's services and compensation, and agreement by the consumer to the arrangement should occur as early as possible in the process. 64 FR 10087.

HUD continues to believe that disclosure is extremely important, and that many of the concerns expressed by borrowers over yield spread premiums can be addressed by disclosing yield spread premiums, borrower compensation to the broker, and the terms of the mortgage loan, so that the borrower may evaluate and choose among alternative loan options.

In the 1999 Statement of Policy, HUD stated:

> * * * HUD believes that for the market to work effectively, borrowers should be afforded a meaningful opportunity to select the most appropriate product and

determine what price they are willing to pay for the loan based on disclosures which provide clear and understandable information.

The Department reiterates its long-standing view that disclosure alone does not make illegal fees legal under RESPA. On the other hand, while under current law, preapplication disclosure to the consumer is not required, HUD believes that fuller information provided at the earliest possible moment in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding. 64 FR 10087.

HUD currently requires the disclosure of yield spread premiums on the Good Faith Estimate and the HUD–1. The 1999 Statement of Policy said:

The Department has always indicated that any fees charged in settlement transactions should be clearly disclosed so that the consumer can understand the nature and recipient of the payment. Code-like abbreviations like 'YSP to DBG, POC', for instance, have been noted. [Footnote omitted.] Also the Department has seen examples on the GFE and/or the settlement statement where the identity and/or purposes of the fees are not clearly disclosed.

The Department considers unclear and confusing disclosures to be contrary to the statute's and the regulation's purposes of making RESPA-covered transactions understandable to the consumer. At a minimum, all fees to the mortgage broker are to be clearly labeled and properly estimated on the GFE. On the settlement statement, the name of the recipient of the fee (in this case, the mortgage broker) is to be clearly labeled and listed, and the fee received from a lender is to be clearly labeled and listed in the interest of clarity. 64 FR 10086-10087.

While the disclosure on the GFE and HUD-1 is required, the Department is aware and has stated that the current GFE/HUD-1 disclosure framework is often insufficient to adequately inform consumers about yield spread premiums and other lender paid fees to brokers. Under the current rules, the GFE need not be provided until after the consumer has applied for a mortgage and may have paid a significant fee, and the HUD-1 is only given at closing. Because of this, HUD has in recent years sought to foster a more consumer beneficial approach to disclosure regarding yield spread premiums through successive rulemaking efforts. This history is discussed more fully in the 1999 Statement of Policy.[2]

Representatives of the mortgage industry have said that since the 1999 Statement of Policy, many brokers provide borrowers a disclosure describing the function of mortgage brokers and stating that a mortgage broker may receive a fee in the transaction from the lender. While the 1999 Statement of Policy commended the National Association of Mortgage Brokers and the Mortgage Bankers Association of America for strongly suggesting such a disclosure to their respective memberships, the Statement of Policy added:

> Although this statement of policy does not mandate disclosures beyond those currently required by RESPA and Regulation X, the most effective approach to disclosure would allow a prospective borrower to properly evaluate the nature of the services and all costs for a broker transaction, and to agree to such services and costs before applying for a loan. Under such an approach, the broker would make the borrower aware of whether the broker is or is not serving as the consumer's

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[2] In both the HUD/Federal Reserve Board Report on RESPA/TILA Reform, 1998, and the HUD/ Treasury Report on Curbing Predatory Home Mortgage Lending, 2000, the agencies recommended earlier disclosures to facilitate shopping and lower settlement costs.

agent to shop for a loan, and the total compensation to be paid to the mortgage broker, including the amounts of each of the fees making up the compensation. 64 FR 10087.

In HUD's view, meaningful disclosure includes many types of information: what services a mortgage broker will perform, the amount of the broker's total compensation for performing those services (including any yield spread premium paid by the lender), and whether or not the broker has an agency or fiduciary relationship with the borrower. The disclosure should also make the borrower aware that he or she may pay higher up front costs for a mortgage with a lower interest rate, or conversely pay a higher interest rate in return for lower up front costs, and should identify the specific trade-off between the amount of the increase in the borrower's monthly payment (and also the increase in the interest rate) and the amount by which up front costs are reduced. HUD believes that disclosure of this information, and written acknowledgment by the borrower that he or she has received the information, should be provided early in the transaction. Such disclosure facilitates comparison shopping by the borrower, to choose the best combination of up front costs and mortgage terms from his or her individual standpoint. HUD regards full disclosure and written acknowledgment by the borrower, at the earliest possible time, as a best practice.

Yield spread premiums are currently required to be listed in the "800" series of the HUD–1 form, listing "Items Payable in Connection with Loan." This existing practice, however, does not disclose the purpose of the yield spread premium, which is to lower up front cost to borrowers. To achieve this end it has been suggested to the Department that the yield spread premium should be reported as a credit to the borrower in the "200" series, among the "Amounts Paid by or in Behalf of Borrowers." The homebuyer or homeowner

could then see that the yield spread premium is reducing closing costs, and also see the extent of the reduction.

HUD believes that improved early disclosure regarding mortgage broker compensation and the entry of yield spread premiums as credits to borrowers on the GFE and the HUD–1 settlement statement are both useful and complementary forms of disclosure. The Department believes that used together these methods of disclosure offer greater assurance that lender payments to mortgage brokers serve borrowers' best interests.

While the 1999 Policy Statement and IV. Part A. of this Statement only cover certain lender payments to mortgage brokers, as described above, HUD also believes that similar information on the trade-off between lower up front costs and higher interest rates and monthly payments should be disclosed to borrowers on all mortgage loan originations, not merely those originated by brokers. HUD is aware that while yield spread premiums are not used in loans originated by lenders, lenders are able to offer loans with low or no up front costs required at closing by charging higher interest rates and recouping the costs by selling the loans into the secondary market for a price representing the difference between the interest rate on the loan and the par, or market, interest rate. Sale of such a loan achieves the same purpose as the yield spread premium does on a loan originated by a broker. The Department strongly believes that all lenders and brokers should provide the level of consumer disclosure that the purposes of RESPA intend and that fair business practices demand. As indicated in the 1999 Statement of Policy, HUD emphasizes that fuller information provided as early as possible in the shopping process would increase consumer satisfaction and reduce the possibility of misunderstanding. In the future, full and early disclosures are factors that the Department would weigh favorably in exercising its enforcement discretion in cases involving mortgage broker

fees. Nevertheless, the Department also again makes clear that disclosure alone does not make illegal fees legal under RESPA. The Department will scrutinize all relevant information in making enforcement decisions, including whether transactions evidence practices that may be illegal.

Part C. Section 8(b) Unearned Fees

A. Background

RESPA was enacted in 1974 to provide consumers "greater and more timely information on the nature of the costs of the [real estate] settlement process" and to protect consumers from "unnecessarily high settlement charges caused by certain abusive practices * * *" 12 U.S.C. 2601.

Since RESPA was enacted, HUD has interpreted Section 8(b) as prohibiting any person from giving or accepting any unearned fees, i.e., charges or payments for real estate settlement services other than for goods or facilities provided or services performed. Payments that are unearned fees for settlement services occur in, but are not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one settlement service provider charges the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

In the first situation, two settlement service providers split or share a fee charged to a consumer and at least part, if not all, of at least one provider's share of the fee is unearned. In the second situation, a settlement service provider charges a fee to a consumer for another provider's services that is

higher than the actual price of such services, and keeps the difference without performing any actual, necessary, and distinct services to justify the additional charge. In the third situation, one settlement service provider charges a fee to a consumer where no work is done or the fee exceeds the reasonable value of the services performed by that provider, and for this reason the fee or any portion thereof for which services are not performed is unearned.

HUD regards all of these situations as legally indistinguishable, in that they involve payments for settlement services where all or a portion of the fees are unearned and, thus, are violative of the statute. HUD, therefore, specifically interprets Section 8(b) as not being limited to situations where at least two persons split or share an unearned fee for the provision to be violated.

As already indicated in this Statement of Policy, meaningful disclosure of all charges and fees is essential under RESPA. Such disclosures help protect consumers from paying unearned or duplicate fees. However, as noted above, in the 1999 Statement of Policy the Department reiterated "its long-standing view that disclosure alone does not make illegal fees legal under RESPA." 64 FR 10087.

B. HUD's Guidance and Regulations

HUD guidance and regulations have consistently interpreted Section 8 as prohibiting all unearned fees. In 1976, HUD issued a Settlement Costs Booklet that provided that "[i] t is also illegal to charge or accept a fee or part of a fee where no service has actually been performed." 41 FR 20289 (May 17, 1976). Between 1976 and 1992, HUD indicated in informal opinions that unearned fees occur where there are

excessive fees charged, regardless of the number of settlement service providers involved.[3]

In the preamble to HUD's 1992 final rule revising Regulation X (57 FR 49600 (November 2, 1992)), HUD stated: "Section 8 of RESPA (12 U.S.C. 2607) prohibits kickbacks for referral of business incident to or part of a settlement service and also prohibits the splitting of a charge for a settlement service, other than for services actually performed (*i.e.*, no payment of unearned fees)." 57 FR 49600 (November 2, 1992).

HUD's regulations, published on November 2, 1992, implement Section 8(b). Section 3500.14(c)[4] provides:

> No person shall give and no person shall accept any portion, split, or percentage of any charge made or

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[3] *See e.g.*, Old Informal Opinion (6), August 16, 1976 and Old Informal Opinion (65), April 4, 1980; Barron and Berenson, *Federal Regulation of Real Estate and Mortgage Lending*, (4th Ed.1998). On November 2, 1992 (57 F.R. 49600), when HUD issued revisions to its RESPA regulations, it withdrew all of its informal counsel opinions and staff interpretations issued before that date. The 1992 rule provided, however, that courts and administrative agencies could use HUD's previous opinions to determine the validity of conduct occurring under the previous version of Regulation X. *See* 24 CFR 3500.4(c).

[4] The heading to 24 CFR 3500.14 is titled "Prohibition against kickbacks and unearned fees." However, the heading of subsection (c) is titled "split of charges," and the preamble to the November 1992 rule states "[s]ection 8 of RESPA (12 U.S.C. 2607) prohibits kickbacks for referral of business incident to or part of a settlement service and also prohibits the splitting of a charge for a settlement service, other than for services actually performed (i.e., no payment of unearned fees)." 57 FR 49600 (November 2, 1992). The rule headings and preamble text are a generalized description of Section 8 that is more developed in the actual regulation text. As discussed in Section D of this Statement of Policy, HUD believes that the actual text of the rules, as amended in 1992, makes clear that Section 8(b)'s prohibitions against unearned fees apply even when only one settlement service provider is involved.

> received for the rendering of a settlement service in connection with a transaction involving a federally-related mortgage loan other than for services actually performed. A charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this Section. The source of the payment does not determine whether or not a service is compensable. Nor may the prohibitions of this part be avoided by creating an arrangement wherein the purchaser of services splits the fee.

24 CFR 3500.14(g)(2) states in part:

> The Department may investigate high prices to see if they are the result of a referral fee or a split of a fee. If the payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of Section 8 and may serve as a basis for a RESPA investigation. High prices standing alone are not proof of a RESPA violation.

24 CFR 3500.14(g)(3) provides in part:

> When a person in a position to refer settlement service business * * * receives a payment for providing additional settlement services as part of a real estate transaction, such payment must be for services that are actual, necessary and distinct from the primary services provided by such person.

In Appendix B to the HUD RESPA regulations, HUD provides illustrations of the requirements of RESPA. Comment 3 states in part:

> The payment of a commission or portion of the * * * premium * * * or receipt of a portion of the payment * * * where no substantial services are being

> performed * * * is a violation of Section 8 of RESPA. It makes no difference whether the payment comes from [the settlement service provider] or the purchaser. The amount of the payment must bear a reasonable relationship to the services rendered. Here [the real estate broker in the example] is being compensated for a referral of business to [the title company].

In 1996, in the preamble to the final rule on the Withdrawal of Employer/ Employee and Computer Loan Origination Systems Exemptions[5] (61 FR 29238 (June 7, 1996)), HUD reiterated its interpretation of Section 8(b) of RESPA as follows:

> HUD believes that Section 8(b) of the statute and the legislative history make clear that no person is allowed to receive 'any portion' of charges for settlement services, except for services actually performed. The provisions of Section 8(b) could apply in a number of situations: (1) where one settlement service provider receives an unearned fee from another provider; (2) where one settlement service provider charges the consumer for third-party services and retains an unearned fee from the payment received; or (3) where one settlement service provider accepts a portion of a charge (including 100% of the charge) for other than services actually performed. The interpretation urged [by the commenters to the proposed rule published on July 21, 1994], that a single settlement service provider can charge unearned or excessive fees so long as the fees are not shared with another, is an unnecessarily restrictive interpretation of a statute designed to reduce unnec-

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[5] This final rule was delayed by legislation, but the Department implemented portions of the final rule that were not affected by the legislative delay on November 15, 1996. 61 FR 58472 (November 15, 1996).

> essary costs to consumers. The Secretary, charged by statute with interpreting RESPA, interprets Section 8(b) to mean that two persons are not required for the provision to be violated. 61 FR 29249.

The latest revision to the Settlement Costs Booklet for consumers, issued in 1997, also provides "[i]t is also illegal for anyone to accept a fee or part of a fee for services if that person has not actually performed settlement services for the fee." 62 FR 31998 (June 11, 1997).

Further, HUD has provided information to the public and the mortgage industry in the "Frequently Asked Questions" section of its RESPA Web site, located at <*http://www.hud.gov/fha/sfh/res/resindus.html*>. Question 25 states:

> Can a lender collect from the borrower an appraisal fee of $200, listing the fee as such on the HUD-1, yet pay an independent appraiser $175 and collect the $25 difference?

The answer reads:

> No, the lender may only collect $175 as the actual charge. It is a violation of Section 8(b) for any person to accept a split of a fee where services are not performed.

In 1999, by letter submitted at the request of the Superior Court of California, Los Angeles County, in the case of *Brown* v. *Washington Mutual Bank* (Case No. BC192874), HUD provided the following response to a specific question posed by the court on lender "markups" of another settlement service provider's fees:

> A lender that purchases third party vendor services for purposes of closing a federally related mortgage loan may not, under RESPA, mark up the third party vendor fees for purposes of making a profit. HUD has consistently advised that where lenders or others charge consumers marked-up prices for services performed by

> the third party providers without performing additional services, such charges constitute "splits of fees" or "unearned fees" in violation of Section 8(b) of RESPA.

HUD noted in its letter to the court that the response reflected the Department's long-standing position.

C. Recent Cases

Notwithstanding HUD's regulations and other guidance, the Court of Appeals for the Seventh Circuit held, in *Echevarria* v. *Chicago Title and Trust Co.*, 256 F.3d 623 (7th Cir. 2001), that Section 8(b) was not violated where a title company, without performing any additional services, charged the plaintiffs more money than was required by the recorder's office to record a deed and the title company then retained the difference. The court reasoned that plaintiffs "failed to plead facts tending to show that Chicago Title illegally shared fees with the Cook County Recorder. The Cook County Recorder received no more than its regular recording fees and it did not give to or arrange for Chicago Title to receive an unearned portion of these fees. The County Recorder has not engaged in the third party involvement necessary to state a claim under [RESPA § 8(b)]." Id. at 626. The court in essence concluded that unearned fees must be passed from one settlement provider to another in order for such fees to violate Section 8(b).

Earlier, in *Willis* v. *Quality Mortgage USA, Inc.*, 5 F. Supp. 2d 1306 (M.D. Ala. 1998), cited by the Seventh Circuit in support of its conclusion, the district court concluded that 24 CFR 3500.14(c), "[w]hen read as a whole," prohibits payments for which no services are performed "only if those payments are split with another party." Id. at 1309. The *Willis* court held that there must be a split of a charge between a settlement service provider and a third party to establish a violation Section 8(b). The court also concluded that 24 CFR 3500.14(g)(3) only applied when there was a payment from a

lender to a broker, or vice versa. The payment from a borrower to a mortgage lender could not be the basis for a violation of 24 CFR 3500.14(g)(3) and Section 8(b).

HUD was not a party to the cases and disagrees with these judicial interpretations of Section 8(b) which it regards as inconsistent with HUD's regulations and HUD's long-standing interpretations of Section 8(b).

D. Unearned Fees Under Section 8(b)

This Statement of Policy reaffirms HUD's existing, long-standing interpretation of Section 8(b) of RESPA. Sections 8(a) and (b) of RESPA contain distinct prohibitions. Section 8(a) prohibits the giving or acceptance of any payment pursuant to an agreement or understanding for the referral of settlement service business involving a federally related mortgage loan; it is intended to eliminate kickbacks or compensated referral arrangements among settlement service providers. Section 8(b) prohibits the giving or accepting of any portion, split, or percentage of any charge other than for goods or facilities provided or services performed; it is intended to eliminate unearned fees. Such fees are contrary to the Congressional finding when enacting RESPA that consumers need protection from unnecessarily high settlement charges. 12 U.S.C. 2601(a).

It is HUD's position that Section 8(b) proscribes the acceptance of any portion or part of a charge other than for services actually performed. Inasmuch as Section 8(b)'s proscription against "any portion, split, or percentage" of an unearned charge for settlement services is written in the disjunctive, the prohibition is not limited to a split. In HUD's view, Section 8(b) forbids the paying or accepting of any portion or percentage of a settlement service— including up to 100%— that is unearned, whether the entire charge is divided or split among more than one person or entity or is retained by a single person. Simply put, given that Section 8(b) proscribes

unearned portions or percentages as well as splits, HUD does not regard the provision as restricting only fee splitting among settlement service providers. Further, since Section 8(b) on its face prohibits the giving or accepting of an unearned fee by any person, and 24 CFR 3500.14(c) speaks of a charge by "a person," it is also incorrect to conclude that the Section 8(b) proscription covers only payments or charges among settlement service providers.[6]

A settlement service provider may not levy an additional charge upon a borrower for another settlement service provider's services without providing additional services that are bona fide and justify the increased charge. Accordingly, a settlement service provider may not mark-up the cost of another provider's services without providing additional settlement services; such payment must be for services that are actual, necessary and distinct services provided to justify the charge. 24 CFR 3500.14(g)(3).[7] The HUD regulation implementing Section 8(b) states: "[a] charge by a person for which no or nominal services are performed or for which duplicative fees are charged is an unearned fee and violates this Section." 24 CFR 3500.14 (c).

The regulations also make clear that a charge by a single service provider where little or no services are performed is an unearned fee that is prohibited by the statute. 24 CFR 3000.14(c). A single service provider is also prohibited from charging a duplicative fee. Further, a single service provider cannot serve in two capacities, e.g., a title agent and closing attorney, and be paid twice for the same service. The fee the

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[6] HUD is, of course, unlikely to direct any enforcement actions against consumers for the payment of unearned fees, because a consumer's intent is to make payment for services, not an unearned fee.

[7] HUD notes that some lenders have charged an additional fee merely for "reviewing" another settlement service provider's services. HUD does not regard such "review" as constituting an actual, necessary, or distinct additional service permissible under HUD's regulations.

service provider would be receiving in this case is duplicative under 24 CFR 3000.14(c) and not necessary and distinct under 24 CFR 3000.14(g)(3). Clearly, in all of these instances, the source of the payment—whether from consumers, other settlement service providers, or other third parties—is not relevant in determining whether the fee is earned or unearned because ultimately, all settlement payments come directly or indirectly from the consumer. See 24 CFR 3500.14(c). Therefore, a single settlement service provider violates Section 8(b) whenever it receives an unearned fee.

A single service provider also may be liable under Section 8(b) when it charges a fee that exceeds the reasonable value of goods, facilities, or services provided. HUD's regulations as noted state: "If the payment of a thing of value bears no relationship to the goods or services provided, then the excess is not for services or goods actually performed or provided." 24 CFR 3500.14(g)(2). Section 8(c)(2) only allows "the payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or services actually performed," i.e., permitting only that compensation which is reasonably related to the goods or facilities provided or services performed. Compensation that is unreasonable is unearned under Section 8(b) and is not bona fide under Section 8(c)(2).

The Secretary, therefore, interprets Section 8(b) of RESPA to prohibit all unearned fees, including, but not limited to, cases where: (1) Two or more persons split a fee for settlement services, any portion of which is unearned; or (2) one settlement service provider marks-up the cost of the services performed or goods provided by another settlement service provider without providing additional actual, necessary, and distinct services, goods, or facilities to justify the additional charge; or (3) one service provider charges the consumer a fee where no, nominal, or duplicative work is

done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.

V. Executive Order 12866, Regulatory Planning and Review

The Office of Management and Budget (OMB) has reviewed this Statement of Policy in accordance with Executive Order 12866, (captioned "Regulatory Planning and Review"). OMB determined that this Statement of Policy is a "significant regulatory action" as defined in Section 3(f) of the Order (although not an economically significant regulatory action under the Order). Any changes to the Statement of Policy resulting from this review are available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk.

Dated: October 15, 2001.

John C. Weicher,

Assistant Secretary for Housing-Federal Housing Commissioner.

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